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Protecting Minority Shareholders in Close Corporations: An Analysis and Critique of the Statutory Protection in the Saudi Companies Law

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PROTECTING MINORITY SHAREHOLDERS IN CLOSE
CORPORATIONS: AN ANALYSIS AND CRITIQUE OF THE
STATUTORY PROTECTION IN THE SAUDI COMPANIES LAW

Abdulrahman Nabil Alsaleh

Submitted to the faculty of Indiana University Maurer School of Law

in partial fulfillment of the requirements

for the degree

Doctor of Juridical Science

April 2019

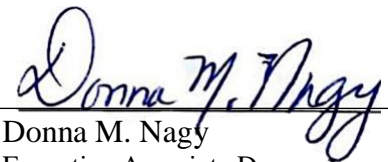
Acceptance Page

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For my mother and father, to whom I am indebted forever.

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Abstract

Worldwide, the protection of minority shareholders in public corporations has received most of the corporate scholars' attention. This tendency, therefore, has been reflected in the negligence of the same group but in close corporations. A close corporation minority shareholder confronts distinctive issues caused by the locked-in structure of close corporations. The lack of liquid secondary market, the oppression by majority shareholders, and the high expectations held by minority shareholders all contribute to the minority shareholders' concern that they may be deprived of a voice in management or opportunistically be taken advantage of by those in power. Although these structural issues are hardly touched upon in the international corporate debates, jurisdictions have varied in their approaches to addressing these issues and providing protection for minority shareholders. The protection may flow from the contractual approach, the statutory approach, the judicial approach, or a combination of the three approaches.

This research demonstrates these issues, and the approaches developed to address them. After that, it explores in depth the statutory approach adopted in the Saudi Companies Law of 2015 to protect the interests of shareholders as the Law advances different rules for corporate governance than their counterparts in other jurisdictions. The study also evaluates the strengths and defects in the Law as it presents an analysis and critique of the statutory treatment of minority shareholders' problems, their statutory protection as well as the public and private enforcement. Finally, the research identifies areas where reforms and changes are needed and thus propound some policy prescriptions to the Saudi legislature to optimize its corporate governance. A new approach to the corporate governance of close corporations, one that is perceptive of their unique nature and features, is necessary to strengthen the statutory protection for minority shareholders, who fail to protect themselves contractually.

Keywords: close corporation, minority shareholder protection, controlling shareholder, Saudi corporate law, corporate governance, director compensation, related-party transactions, shareholder assembly, shareholder oppression.

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Introductory Chapter

“[P]eople enter closely held businesses in the same manner as they enter marriage: optimistically and ill-prepared.”¹

Part I. Preface

In the corporate world, joint-stock corporations have been of great significance to lure investors into investments in major economic projects. This has placed a burden upon the legislative bodies around the world to keep up with their rapidly changing activities and behaviors and regulate them accordingly. Laws and regulations, in general, have worked effectively toward achieving their goals to enhance the market and encourage huge capitals to invest in such corporations.

Despite the continuous qualitative and quantitative development given to the laws and regulations of this type of entity, several issues in some jurisdictions are still unsolved. Such issues appear from the inevitable division between majority shareholders and minority shareholders as a consequence of the nature of the dominant ownership structure. Most of the time such a partition entails the oppression of minority shareholders and the obstruction of right exercising, mainly in close corporations. It is thought that the oppression of minority shareholders has been considered as “an inherent structural characteristic of the close corporation form.”²

Many close corporations are founded based on companionships, familial bonds, and close relationships between shareholders.³ However, these relationships do not form a legal shield upon

¹ Charles W. Murdock, *Evolution of Effective Remedies for Minority Shareholders and Its Impact upon Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425, 426 (1990).

² See Benjamin Means, *A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation*, 97 GEO. L.J. 1207, 1256 (2009).

³ See *infra* Chapter 1, Part I, B.

which the minority shareholders can rely. Close corporations have recorded most of the conflicts and shareholder battles in courts. In response to the widespread dilemma, legislatures around the world have approached the issue in a variety of ways, including reviewing and reforming corporate governance principles and decision-making process within the entity. Other countries have enhanced judicial scrutiny as the voice of the minority is muted or obstructed.

The ninth of November of 2015 was a significant turning point in the history of the corporation in the Kingdom of Saudi Arabia as the long-awaited Companies Law was enacted and introduced to the public, which superseded the forty-four-year-old Companies Law.⁴ It was a sweeping change and development in response to the increasing demand to fill the gaps and correspond to national and international changes. The new Law enhances corporate governance principles and ensures an encouraging corporate atmosphere that is conducive to corporations enhancing their values, activities, and growth as well as their contributions to the Saudi Arabian economy.⁵

The change in the corporate field and the dire need to examine the newly-introduced Law enthused me as a researcher to probe and assess the legislative approach into protecting minority shareholders in close corporations. Therefore, I devote this research to explore the issues of minority shareholders, evaluate the statutory protection they enjoy in light of the 2015 Companies Law in Saudi Arabia, appraise the enforcement's quality of the Law, and introduce some lessons to be gained from far-off jurisdictions to improve and reform existing laws, if any.

⁴ See *infra* Chapter 2, Part I, A (2 and 4).

⁵ See *New Saudi Arabian Companies Law*, DLA Piper, November 12, 2015 [<https://www.dlapiper.com/en/saudi-arabia/insights/publications/2015/11/new-saudi-arabian-companies-law/>].

Part II. The Importance of the Topic

Several causes inspired me to commit my doctoral thesis to the study of minority shareholders' protection in closely held corporations in Saudi Arabia, given its growing importance, legally, socially and economically. First, the Saudi market encompasses thousands of closely held corporations that make significant contributions to the economy. Nevertheless, most of these corporations, if not all, have ignored the rights of minority shareholders to actively take part in the corporate management, or at least oversee the corporate activities as specified by the Law.

Second, since these minority shareholders are the weak, they are often oblivious to their fundamental rights. Some of these rights are attached to the shares (e.g., the right to vote and the right to receive dividends), while others are guaranteed by the Law (e.g., preemptive rights, the right to a representative and the right of access to corporate books and records).

Third, the oppression of minority shareholders and the obstruction of exercising their rights have been regarded as one of the controversial issues in the corporate world today as some scholarly writings have discussed the subject worldwide. Accordingly, countries vary in approaching and addressing the issue. The variation is attributable to the dominating ownership structure in the state. Some countries, for instance, have dispersed ownership (e.g., the U.S. and U.K.) while others, such as Saudi Arabia, have concentrated ownership.⁶ Consequently, different ownership structures differ in their impacts on the corporate governance principles needed to redress the issue, such as the extent of board independence and derivatives' procedures.

Most importantly, one of the themes of the Saudi 2030 Vision is “opening Saudi Arabia for further businesses [...] and improving its business environment.” Such a vision can be achieved only if does the market gain the trust and confidence of foreign investors to invest their capitals in

⁶ See *infra* Chapter 2, Part II,

the market. This involves that related-investment laws and regulations are protective of minority shareholders and able to earn investors' confidence in "the resilience and potential of [Saudi] national economy."

Since this study is regarded as one of the first academic studies that undertake the analysis and assessment of the corporate governance of the 2015 Companies Law, it will be of great help for the Saudi legislature and for the Saudi public to look at the law and the protection it promotes through an academic lens. Given the importance and the size of the Saudi market alongside the pivotal role played by corporations, such an area of law should receive much attention from legal scholars who examine current laws and reconsider its concepts and principles. Academics, more than others, should study and criticize contemporary laws to ensure that they serve their proclaimed objectives.

For the reasons mentioned above, I devote my SJD research to articulate the dilemma of minority shareholders in closely held companies in Saudi Arabia. The study carries out an in-depth academic investigation about the minority shareholders with a thoroughly analytical and critical review of the Companies Law. The primary goal of this research is threefold: first, to spot the loopholes in the Law and its failure to statutorily protect minority shareholders; second, explore and accentuate the protective aspects of the 2015 Companies Law; and third, make several recommendations to improve the quality of the legal system and enhance the enforcement of the law.

Part IV. Research Questions and Challenges

The study answers the fundamental question of whether minority shareholders of the joint-stock companies are protected in Saudi Arabia theoretically and practically. In answering this question, the following questions emerge:

1. What is the significance of answering this main question?
2. Why should minority shareholders be protected?
3. What is the difference between ex ante and ex post protection?
4. What does “minority shareholders” mean? What constitutes minority shareholders and vice versa?
5. What is the importance of statutory protection for minority shareholders?
6. What kind of legal aspects should the legislature protect?
7. How has the Saudi legislature protected the interest of minority shareholders via the new Law?
8. Has the new Law failed in corresponding to issues concerning the minority?
9. What are the practical obstacles in the way of statutory protection for minority shareholders?
10. What legislative improvements should be made to the Saudi Companies Law?
11. What are the legal measures to bring about the necessary improvements?

Part V. Methodology and Research Approach

The goal of the thesis is mainly to explore the statutory protection for minority shareholders under the Companies Law of 2015. Therefore, both the methodology and method for the research have been selected accordingly.

The thesis is built upon a case study approach. Stake defines the case study approach as “the study of the particularity and complexity of a single case, coming to understand its activity within important circumstances.”⁷ it gains more importance if the conducted research has “a very special of interest.”⁸ A pair of reasons can justify the choice of the case study to approach the research questions and attain the research objectives. First of all, the legal system of Saudi Arabia is

⁷ See ROBERT STAKE, THE ART OF CASE STUDY RESEARCH (SAGE PUB. LTD. 1995).

⁸ *Id.*

regarded as a very complicated legal system that has always caused legal perplexity, “not only for foreigners but also among Saudis themselves.”⁹ A lot of inconsistency and uncertainty have been attributed to the double nature of its legal institutions where “modern legal arrangements and institutions combine and interact in a rather contradictory way, with Islamic applications and attitudes.”¹⁰ To deal with such complex settings, the case study methodology has been believed to be best positioned to the scrutiny of a particular condition of the position of a specific case.¹¹

The scarcity of sources and writings about the Saudi legal system in general and the subject matter, in particular, is another ground justifying the case study approach, as it is deemed a significant methodology when there is a gap in the literature encompassing the legal position of a specific case.¹²

To accomplish the thesis’s goals and to answer the questions above, some research methods have been rejected in favor of the normative study. The dissertation is mainly normative within a conceptual and analytical framework. To that end, the research, as mentioned above, aims at presenting issues concerning the Saudi regulations of joint-stock companies, particularly exploring and analyzing the 2015 Companies Law and then assessing the efficacy of its statutory protection for minority shareholders by comparing its protective aspects to more advanced laws and regulations of other legal systems. In this regard, it has been pointed out that one of the main objectives of comparative law is to facilitate legislative reforms and legal improvements.¹³ Laws

⁹ FAHAD M. ALMAJID, A CONCEPTUAL LEGAL FRAMEWORK FOR REFORMING SAUDI CORPORATE GOVERNANCE (LAMBERT ACADEMIC PUBLISHING, 2014).

¹⁰ *Id.*

¹¹ See CATHERINE CASSELL & GILLIAN SYMON, ESSENTIAL GUIDE TO QUALITATIVE METHODS IN ORGANIZATIONAL RESEARCH, 324 (SAGE PUBLISHING, LTD 2004).

¹² See Izak Benbasat, David K. Goldstein and Melissa Mead, *The Case Research Strategy in Studies of Information Systems* 11 MIS QUARTERLY 396, 370 (1987).

¹³ See Jonathan Hill, *Comparative Law, Law Reform and Legal Theory*, 9 OXFORD J. LEGAL STUD. 101, 115 (1989).

such as the United States and the United Kingdom's are broadly used as guidelines for the needed reforms in most developing and transitional countries, including Saudi Arabia. Note that this is not a comparative study. Instead, it utilizes comparison as a way to advance and support an argument on the one hand, or refute and exemplify a position on the other.

Primary and secondary sources are used throughout the study. However, due to the dearth of academic literature dealing with businesses in Saudi Arabia and the apparent lack of secondary resources on the subject matter, it is essential to refer to the secondary resources of other advanced legal systems in analyzing and discussing the case of Saudi Arabia.

A. Primary Resources

The study mainly undertakes the analysis and evaluation of the protection for minority shareholders in close corporations in Saudi Arabia. Therefore, many regulations and laws governing the corporation in Saudi Arabia are the starting point of this thesis. Such laws and regulations are the Companies Law of 2015, the Law of Commercial Court, and other regulations and ministerial guidelines.¹⁴

In the context of cases and precedents concerning the topic, the recentness of a reporting system—alongside the newness of the Law— in Saudi Arabia makes it challenging to acquire details of judicial decisions, so it is difficult to articulate on the judicial approach in interpreting and applying the Law. In addition, policy statements, guidelines and administrative decisions by authorities (e.g., the Ministry of Commerce and Investment) concerning the close corporations are of paramount importance to the study and analysis in this thesis. Last, Other primary resources of other advanced legal systems (e.g., the Model Business Corporation Act in the United States) are

¹⁴ See generally *infra* Chapter two, Part I.

of great help in achieving the aims of the study.

B. Secondary Resources

The research questions and challenges demand a thorough investigation of different sources from several disciplines, including those concerning finance, politics and the theories of regulations. The thesis often references secondary resources (e.g., books, law review articles, and reports) to draw a full and clear vision of the theoretical and practical aspects of the subject matter.

As articulated above, the research builds on several previous academic writings (in other countries) that have elaborated on the issues of minority shareholders in close corporations. These resources are sometimes used to propose a blueprint for reforming related-Saudi laws. Journal articles and internet sources provide essential, up-to-date information and qualitative analyses to the research to mirror what has been on the ground.

All primary and secondary sources are fully referenced throughout the thesis in compliance with the Bluebook standard for citation of legal resources. It should be emphasized that most of the references are secondary even though primary sources of the laws and the regulations are favored continuously and given primacy over secondary sources. It is wished that the weight of referencing does not disturb the quality and the course of the arguments demonstrated throughout the research.

Part VI. The Structure of the Thesis

The thesis is divided into an introduction, five chapters, and a conclusion. At the outset of every chapter, there is a motivating hypothetical that illustrates the issue and helps the reader have a clear sense of the subject matter under the spotlight.

Chapter one is a foundational, expository chapter that establishes a necessary layer to comprehend the issues that minority shareholder status triggers in close corporations. It is divided

into three sections. First, it starts with defining the terms “minority shareholder” and “close corporation”. Second, it spotlights common issues that arise out of the close corporation’s structure worldwide. The third section contains a conceptual categorization of strategies that are used to tackle the issues. The categorization is premised upon the source from which each strategy flows.

The second chapter aims at delineating the corporate arena in Saudi Arabia and establishes the legal ground upon which a corporation is incorporated and regulated. It is divided into two sections. The first section offers a comprehensive overview of the legal structure governing Saudi corporations. This includes a historical snapshot of the inception and the developments of the Saudi corporate laws and regulations. The second section maps out the unique structure of ownership in the region. This encapsulates, on the one hand, the ownership structure of publicly-traded corporations—including state-controlled corporations, and family-controlled corporations— and the ownership structure of closely held corporations by state and family, on the other hand.

Chapter three investigates the internal legal framework of joint-stock corporations in Saudi Arabia according to the default rules of the Law regulating corporate institutions, operations, and other corporate affairs. This chapter is intended to dissect the rules through an analytical and critical lens, rather than descriptive one, yet the description of the rules is provided to comprehend better the detailed analysis and constructive criticism of the Law that follows. First, it starts with a straight procedural section about the incorporation requirements, including the incorporation of a one-person corporation. Second, it casts light on the role of shareholder and shareholder meetings, through which they exercise most of their rights, yet it does not exhaust all shareholder matters as most of them are examined in a later chapter designated to the statutory protection of minority shareholders. Third, the chapter probes the rules of corporate management, including the composition of the board of directors, its meetings, and its duties and responsibilities along with

the remuneration-rewards rules. Fourth, it casts light on the role of the external auditor, including its appointment, powers, and tasks. In the end, the chapter concludes with an in-depth analysis of the procedural and substantive rules regulating close corporations.

Turning to chapter four, it presents a case study of minority shareholder protection in Saudi Arabia. It is divided into five sections. The first part introduces the reader to minority shareholders' issues in Saudi Arabia and the factors that affected the change in the policy of protecting their interests, leading to an indispensable role of the law in the region. The second part offers an analysis of the statutory shareholder rights, including defining the "statutory right" and categorizing them into two groups. The third part demonstrates—through analytical reading—how the Law is an effective device to curtail oppressive conduct, and how it handles minority shareholders' issues, including minority's directorial representation, dilution of interests, unmarketability of shares. The fourth part underscores the role of formalism in the Law in one section and highlights some issues and limitations associated with this statutory approach in the other.

The fifth chapter scrutinizes the second component of the research theory, enforcement of the Law in Saudi Arabia as it is a major player in protecting minority shareholder's interests. Laws and rules alone do not suffice to protect minority shareholders. Instead, they are to exist interdependently. For this reason, this chapter expounds the role of the judiciary *ex post*, as it is the sanctuary for all disgruntled and oppressed shareholders on the one hand, and the principal enforcer of the law on the other. To do so, the chapter first provides a foundational stone of the historical development of the corporate judiciary in Saudi Arabia. Second, the chapter differentiates between the role of the judiciary in enforcement into two subsections: public

enforcement and private enforcement. Under each category, the chapter examines the nature of the judicial interventions ex post and accentuates the protective aspects of such interventions.

The conclusion features the findings of previous analyzed chapters. It also provides overall recommendations that have emerged from the analysis as well as illuminate the obstructions and limitations that have been tackled in the study and offer some suggestions for future research.

Part VII. The Scope of the Study

The dissertation covers the regulations and laws of closely held corporations in Saudi Arabia. Public corporations are excluded because they have been the subject of several scholarly studies. In a few stances, I refer to the corporate law of a member country of the Gulf Cooperation Council (GCC) due to the possible integration of the six states facilitated by their cultural, social, and ideological similarities.¹⁵ Overall, it should be emphasized that the examination of the Saudi aspects is given greater weight than models from other countries to allow for better solutions and recommendations and to comply with the research methodology of case-studying the protection of minority shareholders within Saudi Arabia.

Turning to the research tools, interviews and questionnaires were thought unsuitable because such methods would meet practical barriers due to language differences, a possible lack of cooperation, and difficulties to access unpublished cases and precedents. Moreover, the possibility of subjective bias among individual actors involved in the examined system (along with the political, regulatory and commercial requirements of confidentiality) would hinder any reliable

¹⁵ The GCC is an Arab regional organization of six Arab countries; United Arab Emirates, Qatar, Saudi Arabia, Bahrain, Kuwait, and Oman. It was founded in 1981, and its headquarters are in Riyadh, the capital of Saudi Arabia. These countries are the most productive oil countries in the Middle East Plus, articles that make up the laws of most GCC countries are identical. In addition, Qatar, the United Arab Emirates, and the State of Kuwait have recently introduced new companies laws. For this reason, the study sometimes refers to their corporate laws rather than considering all six countries.

evaluation. Although the Saudi judiciary (namely commercial courts) has recently begun publishing cases and judicial rulings on its website, the system lacks the proper codification system—which would otherwise ease the search for rulings related to the subject matter.

Furthermore, given the scarcity of English-written references about the Saudi laws in general and the subject matter in particular, a great deal of Arabic-English translation is required. This limitation appears to be a chance to take the lead in presenting the Saudi Companies Law of 2015 to Western readers with the hope that it becomes an essential reference for future research on the topic.

Chapter One: The Concept of Minority Shareholders in Close Corporation

*“There are 51 shares that are worth \$250,000. There are 49 shares that are not worth a . . .”*¹⁶

John H. Doyle

Motivating Hypothetical

Saad, a teacher with no business background, is pondering over a business opportunity that his father, Fahad, has invited him to join him in launching a new business, which needs a statutory minimum of two shareholders to incorporate a joint-stock corporation under the 2015 Saudi Companies Law. The offer is to contribute 10% of the company’s capital or 25% if his brother wants to join. Saad has no knowledge in business and no background about the law, so in his risk assessment phase, he is wondering about the legal risks associated with the proposed ownership in this sort of corporation.

The Scope of Chapter One

This foundational, expository chapter establishes a primary layer to comprehend the issues that the minority shareholder status triggers in close corporations. It is divided into three sections. First, it starts with defining the terms “minority shareholder” and “close corporation”. Second, it spotlights common issues that arise out of the close corporation’s structure. The third section provides a conceptual categorization of strategies that are used to tackle the issues. These strategies are divided based on the source from which each strategy flows.

¹⁶ See *Humphrys v. Winous Co.*, 165 Ohio St. 45, 50, 133 N.E.2d 780, 783 (1956) (quoting John Doyle’s address before the 1893 annual meeting of the Ohio State Bar).

Part I. Definition

A. The Definition of Minority Shareholder

The minority term in a corporate context is commonly understood as the possession of less than half of the corporation's capital. However, there are two common standards to define minority shareholders. First, the quantitative measure. According to Black's Law Dictionary, minority shareholder means "[a] shareholder who owns less than half the total shares outstanding and thus cannot control the corporation's management or singlehandedly elect directors."¹⁷ This shareholding may belong to one person or a group of shareholders.

Another measure applied to define minority shareholders is the qualitative standard. This measure depends on an evaluation of the control exerted over the corporation. Sometimes a shareholder has minority status according to the quantitative standard, yet the shareholder exerts control over the corporation and has managerial and directorial powers. These powers often come through *ax ante* contracting and other arrangements. In this sense, a quantitatively-defined minority shareholder with veto power over some transactions becomes a qualitatively-defined majority. Both standards go hand in hand and are of paramount significance in a court of law to prove the entitlement of minority shareholders to the statutory and judicial protection.¹⁸

The minority concept arises following the recognition of separate legal personality for the corporation, and then the domination of major shareholders over the corporation in a way that results in oppression for other disgruntled shareholders, or later so-called the minority. Given the importance of the shareholder's role in corporations, it is of necessity to intervene and re-balance

¹⁷ BRYAN A. GARNER, BLACK'S LAW DICTIONARY, 1586 (10.ed 2014).

¹⁸ *see* Julian Javier Garza, *Rethinking Corporate Governance: The Role of Minority Shareholders - A Comparative Study*, 31 ST. MARY'S L.J. 613, 620 (2000).

the relationships between the minority and the majority for the sake of the entity and its objectives. The intervention has taken various styles worldwide.

In the review of the Saudi Arabian statutes and laws regulating close corporations, however, it appears that the Saudi legislature has not adopted a precise definition of the minority, and it has not singled out a specific chapter or section of its corporate law for the treatment of corporate minorities. This seems similar to other corporate laws of various jurisdictions.¹⁹ Nevertheless, this does not negate the existence of the statutory protection for minority shareholders under the Saudi Companies Law of 2015 as it is illustrated later in this thesis.

For this study and in avoidance of the perplexity of the terminology, the term “minority shareholder” denotes powerless shareholders who are destitute of control over the corporation’s decisions and its board of directors, irrespective to their ownership interests in the corporate capital. In most circumstances, if not all, these minorities own less than fifty percent of the capital, but there are situations where minorities own more than the half, yet they are considered minorities due to the fact that their ownerships are widely dispersed, or because of the privileges and preferences the dominant shareholder has secured by contract.

B. The Definition of Close Corporation

The Saudi Companies Law has neither defined the close corporation status nor has it capped the number of shareholders the corporation may have. Instead, an enterprise is considered to have the close corporation status as long as its shares are neither listed on nor traded through the capital market, irrelevant to the number of its shareholders.

¹⁹ See *Generally* REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 89–99 (Oxford Univ. Press 2nd. ed. 2009) (presenting that minority concepts are well articulated by judicial rulings in a number of jurisdictions, such as the United States, the United Kingdom, Japan, Italy, Germany and France).

Comparatively, some U.S. state courts have set several definitions that orbit around the special features of the close corporation. Such features are (1) legal personality, (2) limited liability, (3) the small number of owners, (4) illiquidity of shares due to the absence of a ready market, and (5) centralized management.²⁰ Comparably, the Black's Law Dictionary defines a close corporation as "[a] corporation whose stock is not freely traded and is held by only a few shareholders (often with the same family)."²¹

Alternatively, some jurisdictions have statutorily recognized close corporations as separate status from the public corporation status and thus have enacted special statutes regulating close corporations.²² To elect the close corporation status, the law requires that the number of shareholders not to exceed the statutory cap (e.g., ten or fewer shareholders) to be eligible for such election. Statutory close corporations differ from regular close corporations whose owners do not affirmatively elect at the time of incorporation to be a statutory close corporation, and thus subject to the general corporation law.²³

For the purpose of this research, the term "close corporation" is used to indicate incorporated enterprises with capitals divided into shares that have no ready market through which holders of

²⁰ See, e.g., *Donahue v. Rodd Electrotape Co.*, 367 Mass. 578, 328 N.E.2d 505 (1975).

²¹ BRYAN A. GARNER, BLACK'S LAW DICTIONARY, 416 (10.ed 2014) (including closely held corporation and closed corporation in its definition of the close corporation).

²² Such states are California, Delaware, and Arizona.

²³ For further discussion about the status of statutory close corporations and its advantages and disadvantages, see Don Berger, *Statutory Close or Closely Held Corporation*, 11 PAC. L. J. 699 (1980).

these shares would trade. The terms close corporation, closely held corporation,²⁴ and joint-stock company are used interchangeably in this research to mean the same unless otherwise noted.²⁵

Part II. Minority shareholders' predicaments in Close Corporations²⁶

Minority shareholder's dilemma may seem to be universal in terms of the nature of the issues minorities across jurisdictions confront.²⁷ Such issues are unmarketability of shares, dilution of ownership interests, the absence of managerial involvement combined with different expectations held by minority shareholders, shareholder oppression, and majority opportunism. It is worth noting that these issues may overlap and interlock, which creates difficulty under which issue a given scenario should be placed.

²⁴ REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH*, 12 (Oxford Univ. Press 2nd. ed. 2009) (differentiating between closely held corporations, whose shares are owned by a few shareholders with important "interpersonal relationships . . . to the management of the firm," and widely held corporations, "whose shares are not freely tradeable but that nevertheless have hundreds or thousands of shareholders.")

²⁵ *Contra* the terms of public company, public corporation, quoted companies, and publicly traded companies are used interchangeably to represent corporations whose shares are listed on and traded through a stock exchange.

²⁶ Due to the lack of literature about the subject matter in Saudi Arabia, the U.S. literature has been selected to provide a broad overview about the minority shareholders' problems in American close corporations that may take place in Saudi close corporations as well. It is worth keeping in mind that this article does not excessively cover the development of minority shareholder oppression and other issues in the United States, rather it provides the reader with a short-cut background and the gist of the subject matter in an effort to create a blueprint upon which the analysis and exploration of the Saudi Companies Law is premised.

²⁷ See John H. Matheson & R. Kevin Maler, *A Simple Statutory Solution to Minority Oppression in the Closely Held Business*, 91 MINN. L. REV. 657, 758 (2007) (asserting that the issues of minority shareholders in close corporations are non-conclusive to the United States, but rather "they are part of the fabric of modern business organization law on a global scale.") See, e.g., A.J. BOYLE, *MINORITY SHAREHOLDERS' REMEDIES* 38–59, 90–118 (2002) (demonstrating the company law governing minority shareholders' remedies from historical, theoretical, and comparative perspectives in the United Kingdom); Cindy A. Schipani & Junhai Liu, *Corporate Governance in China: Then & Now*, 2002 COLUM. BUS. L. REV. 1, 36–38 (2002) (raising concerns about the severity of minority oppression in China); Nigel Furry, *The Statutory Protection of Minority Shareholders in United Kingdom*, 22 WAKE FOREST L. REV. 81 (1987) (analyzing the willingness of the U.K courts to shelter minority shareholders' interests).

A. Unmarketability of Shares

One of the fundamental features of the corporation is that the interests of business partners are originally transferable.²⁸ Transferability of shares provides free rein for the corporation to operate and accomplish its objectives regardless of the change in its owners, who in principle enjoy liquidity of their interests.²⁹

In close corporations, however, shareholders' right to transfer their shares does not imply the tradability of shares. Unlike public companies,³⁰ close corporations lack the market where shareholders would sell their interests and exit the firm for a fair price. The absence of an established market entails that displeased shareholders cannot escape from the entity without their interests being undervalued as a result of the deduction of risks associated with their interests (minority discount).^{31 32}

As the shares in close corporations lack marketability, they oftentimes undergo a wide range of restrictions on their transferability. Given the small number of shareholders in the close corporation and the interpersonal relationships between them, shareholders prefer to place

²⁸ See REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH*, 11 (Oxford Univ. Press 2nd. ed. 2009) (explaining that transferability of shares is "[a] basic characteristic of the business corporation", which makes it distinguishable from the partnership form, another vehicle to carry out businesses).

²⁹ *Id.* at 11, footnote 8, (asserting that liquidity of shareholders' interests gives shareholders an advantage to have diversified portfolios as free tradability, on the other hand, boosts the liquidity of investments).

³⁰ The traditional corporate norm of free transferability is better associated with publicly held corporations where a separation between ownership and management exists. "Traditional corporate norms, oriented as they are toward publicly held corporations, proved unsuitable for close corporations." See Robert B. Thompson, *The Shareholder's Cause of Action for Oppression*, 48 BUS. LAW. 699, 702 (1992).

³¹ See F. Hodge O'Neal & Walter G. Moeling, IV, *Problems of Minority shareholders in Michigan Close Corporations*, 723, 724 14 WAYNE L. REV. 723 (1968); O'KELLEY THOMPSON, *CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS CASES AND MATERIALS* ch.5 (Aspen Publishers 6th ed. 2010).

³² See Arthur R. Pinto, *Protection of Close Corporation Minority Shareholders in the United States*, 62 AM. J. COMP. L. SUPP. 361, 370 Footnote 56 (2014) ("A minority discount reflects the fact that minority shareholder often lack corporate decision-making power while a lack of marketability discount further reduces the value of shares because no ready market exists where the shares could be sold or resold. The prospect of obtaining the minority's shares, and doing so at a discount from "fair" value, may create incentives for the majority to squeeze out the minority by one means or another")

restrictions on their shares in an effort to maintain their interests within the group and avoid any entry of a third party they may dislike. Notwithstanding the rationale behind placing these restrictions, they are, nevertheless, recognized by corporate laws in most jurisdictions, including Saudi Arabia, yet the treatment of these restrictions may differ from one to another.³³

B. Dilution of the Ownership Interests³⁴

Another issue that minority shareholders in close corporations worry about is the dilution of their shareholdings due to share issuance. As the majority rules the corporation and has the ultimate say in the corporation's resolutions, it may at some point issue additional shares and sell them to itself, or a third party at a favorable price.³⁵ The problem of share issuance exacerbates when the default law of the pre-emptive rights is eliminated by the bylaws of the corporation or its certificate of incorporation.³⁶ Otherwise, the majority issues shares at a time when the minority is unable to exercise its right due to a lack of money to participate in the capital raising.³⁷

³³ See REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH*, 12 (Oxford Univ. Press 2nd. ed. 2009) (emphasizing that “all jurisdictions . . . provide mechanisms for restricting transferability.”)

³⁴ The statutory treatment for this issue will be extensively discussed and reviewed in another chapter probing the rules and regulations of joint-stock companies in the Saudi Companies Law of 2015. The Saudi Companies Law, akin to its counterparts, regulates the issuance of new shares and sets forth rules for the exercise of preemptive rights in such situations.

³⁵ See F. Hodge O'Neal & Walter G. Moeling, IV, *Problems of Minority shareholders in Michigan Close Corporations*, 723, 724 14 WAYNE L. REV. 748 (1968).

³⁶ “[T]he preemptive right of shareholders means to acquire newly issued shares from the corporation of which they are shareholders is considered to refer to their right to purchase a portion of such shares pro rata to their existing holdings.” Andrew L. Nichols, *Shareholder Preemptive Rights*, 39 BOSTON BAR J. 4, 5 (1995).

³⁷ In such cases in the United States, minority shareholders may, based on the fiduciary duty, have a claim against the majority. See, e.g., *Kullgren v. Navy Gas & Supply Co.*, 110 Colo. 454, 135 P.2d 1007 (1943), as dominant shareholders wanted to issue shares just to empower themselves. However, if the issuance of shares were for a good business reason and at a fair price, it would be likely difficult to challenge such a corporate resolution. See generally *Pinto*, Protection in the U.S. at 367. See, e.g., *Hyman v. Velsicol Corp.*, 342 Ill. App. 489, 97 N.E.2d 122 (1951).

C. Shareholder Expectations

One of the traditional attributes of the close corporation is the small number of its shareholders.³⁸ These shareholders act as co-owners of the business, and most of the time they treat each other as partners.³⁹ Despite the delegation of the management to a separate directorial body (as a unique facet of the corporation),⁴⁰ shareholders in close corporations expect to co-run the business and have a say in its decision-making process.⁴¹ The expectations of these shareholders intensify when the relationships between shareholders embody interpersonal ties and familial bonds.⁴² Not only do they advance money for the corporation capital, but they also invest skills and devote time, hoping to obtain in return not only dividends but also salaried positions in their corporations.

³⁸ See *supra* § I, 2.

³⁹ Close corporations are commonly considered as intimate enterprises that lack the separation between ownership and management, giving rise to expectations of shareholders far beyond what corporate laws aim to protect. See Adam Chernichaw, *Oppressed Shareholders in Close Corporations: A Market Oriented Statutory Remedy*, 16 CARDOZO L. REV. 501, 507 (1994).

⁴⁰ Delegated management is an essential stone in the corporation personality, and this is what makes corporations stand out from partnerships, limited liability companies, and business trusts as they “cannot have a board structure similar to . . . a typical corporation.” See REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH*, 12 (Oxford Univ. Press 2nd. ed. 2009)

⁴¹ See Robert B. Thompson, *The Shareholder's Cause of Action for Oppression*, 48 BUS. LAW. 699, 702 (1992) (“Shareholders in a close corporation usually expect employment and a meaningful role in management as well as a return on the money paid for the shares.”)

⁴² O’KELLEY THOMPSON, *CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS CASES AND MATERIALS* 447 (Aspen Publishers 6th ed. 2010) (describing close corporations as intimate enterprises that may conflict with the long-rooted norms of corporate law, such as the lack of separation between the management of the corporation and its owners’ investments. the relationships between the owners of the corporation commonly “overlap family or other close personal ties, adding another layer of expectations and creating various means of interaction beyond that those provided by the structures of entity law.”) Close corporations built upon close relationships between their shareholders can be also called “archetypical close corporations,” see Chares O’kelley, Jr., Commentary, *Filling Gaps in the Close Corporations Contract: A Transaction Cost Analysis*, 87 NW. U. L. REV. 216, 238 (1992).

This may sound ideal; however, such expectations by minority shareholders put a burden upon them to secure these positions through contracting ex ante.⁴³ Nevertheless, given the deficiency of bargaining power and the absence of well-suited corporate law norms to the close corporation's extraordinary nature,⁴⁴ minority shareholders should accept the reality of the majority primacy.⁴⁵ As long as the majority discharges its duties in good faith and pursuant to its fiduciary duties of care and loyalty (e.g., lawful elimination of returns on investments or lawful removal from a directorial or managerial position), the minority does not have much but to be under the majority's mercy, given that the statutory remedies are unlikely triggered.⁴⁶

The absence of the management participation—not being on the board of directors or serving as an officer—triggers another issue that the minority shareholders become unaware of the corporation's activities and unable to access the corporation's books and records.⁴⁷ The blocking of or the limitation on the access to information has adverse impacts on the exercise of shareholder's rights, such as informed voting.⁴⁸ Also, it leads to an undervaluation of their shares; these shares are, and will probably be, underpriced because of the risks of uncertainty and lack of power linked to them.⁴⁹

⁴³ Contractual protection is claimed to offer greater protection for the minority as it will be shortly explained. *See infra* § III, C.

⁴⁴ *See supra* § I, B.

⁴⁵ *See, e.g.,* John H. Matheson & Brent A. Olson, *Corporate Cooperation, Relationship Management, and the Trialogical Imperative for Corporate Law*, 78 MINN. L. REV. 1443, 1461 (1994) (explaining the shareholder primacy model as it has the right for the majority to select the corporation's fate and formulate its policies and goals).

⁴⁶ *See* Pinto, *Protection in the U.S.* at 366, (“Unless there is such a showing or some contractual right or understanding that dividends should be paid, there is no right to receive a return through a dividend.”)

⁴⁷ *See* Keith Rogers, *Protecting Minority Shareholders in Alaska Close Corporations*, 24 ALASKA L. REV. 45, 58 (2007).

⁴⁸ The right to access the books and records of a corporation under the Saudi Companies Law of 2015 is discussed in a subsequent chapter.

⁴⁹ As shown under the Unmarketability subtitle, closely held corporations lack the liquidity feature that is recognized in publicly traded corporations. Shareholders in these corporations cannot easily liquidate their investments or at least get fair value for their interests without deduction of the risks involved in such ownership interests. *See supra* note 37 and accompanying text.

Moreover, when the minority shareholders are neither elected nor selected for corporate paid positions, the only remaining hope for them is to at least receive dividends in return for their investments in the corporate capital. However, the decision to distribute dividends is at the majority's discretion.⁵⁰ Unless the majority abuses its discretion or acts in bad faith, minority shareholders appear to be handcuffed and "in danger of being frozen out"⁵¹ as the returns on their investments may be eliminated for an indefinite period.⁵² Of course, the abuse of power and refusal to declare dividends are subject to, and a question of fact left to, the judiciary deciding case by case and checking whether the majority has breached its fiduciary duties.⁵³ Failure to meet the expectations of minority shareholders may, the court finds, constitute oppression as a cause of action and thus a justifiable claim for remedy.⁵⁴

D. Majority Opportunism and Oppression⁵⁵

Due to the minority shareholder's vulnerable position, the majority may find it tempting to take actions that may sound oppressive of minority shareholders. In other words, the fragile

⁵⁰ However, some corporate laws have quite different treatments for dividend distributions. The rules of dividends in the Saudi Companies Law will be explained later in this research.

⁵¹ See Keith Rogers, *Protecting Minority Shareholders in Alaska Close Corporations*, 24 ALASKA L. REV. 45, 58 (2007) (asserting that "the two ways... for an investor to receive a return on her investment . . . are through employment with the company and through dividends. Unless a minority shareholder is able to secure her rights through a shareholders' agreement or a supermajority voting provision in the charter at the inception of a close corporation, . . . the majority can use its voting power to deny her a job and refuse to declare dividends.") See Also F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS §1.09 (3d ed. 1994).

⁵² See Michael E. Brown, *Missouri Close Corporations: Proposals to Strengthen Protections for Minority Shareholders*, 68 UMKC L. REV. 145, 146 (1999).

⁵³ See, e.g., *Miller v. Magline, Inc.*, 256 N.W.2d 761 (Mich. App. 1977) (stipulating that denying dividend to shareholders was a breach of fiduciary duty owed by the directors according to their history); *Nixon v. Blackwell*, 626 A.2d 1366 (Del. 1993) (rejecting the equal opportunity doctrine that offer greater protection for shareholders of close corporations).

⁵⁴ See Robert B. Thompson, *The Shareholder's Cause of Action for Oppression*, 48 BUS. LAW. 699, 708 (1992) ("Oppressive conduct by the majority . . . is listed widely in most state dissolution statutes, and . . . the principal vehicle used by legislatures, courts, and litigants to address the particular needs of close corporations.")

⁵⁵ Sometimes statutes and corporate laws refer to oppression as "unfairly prejudicial." See e.g., Alaska, California, and Minnesota.

standing of minority shareholders may adversely incentivize the majority to perform opportunistically. The majority opportunism—along with the subsequent conflict of interests between the majority and the minority—is also considered one of the agency problems,⁵⁶ as Kraakman and his co-authors refer to it as “the second agency problem.”⁵⁷

Oppression of minority shareholders transpires when an individual or a group of owners decides to ostracize or minimize the influence of their partners, whose expectations then become defeated and frustrated. The rationale behind these oppressive activities varies from one case to another, ranging from hunger for power, the dream of avarice, and personality clashes to the death of the founder.⁵⁸

In general, the concept of minority shareholder oppression has been the subject of both legislative and judicial interventions. In terms of the legislative response, several corporate laws and statutes have warranted a finding of oppression of minority shareholders in close corporations a cause of action for the termination of the business and the dissolution of the corporation.⁵⁹ Nevertheless, the legislatures have left the door open for the judiciary to interpret and define oppression and then filter, via case-by-case analysis, what actions could establish it.

⁵⁶ An agency problem is an economic term used whenever the welfare of one party (the principal) depends upon the actions taken by another party (the agent). It is also known as the principal-agent problem. REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH*, 35 (Oxford Univ. Press 2nd. ed. 2009).

⁵⁷ In the corporate context, the second agency problem occurs as a result of a conflict of interest between the majority shareholder (the principal) and the minority shareholders (the agent). However, it is worth noting that this problem raises to the surface whenever a group of the business’s owners has power over the resolutions impacting the remainder of owners. For example, minority shareholders with veto rights *See Id.* at 36.

⁵⁸ The death of the founder of the business seems to be a common motive for oppression in Saudi Arabia, given the special nature of Sharia inheritance rules. *See infra* note **Error! Bookmark not defined.**

⁵⁹ *See, e.g.*, Missouri Revised Statutes, MO. Rev. Stat § 351.494 (2012) (citing grounds for judicial dissolution).

Unlike fraudulent and illegal acts,⁶⁰ the definition of oppression has been judicially-developed to be different from fraud and illegality.⁶¹ Many states in the United States, have found that oppression should be construed to encompass an array of circumstances dealing with abusive conduct, such as a lack of shareholder's integrity, harsh treatment toward the minority, and prejudice against it.⁶² Without the oppression concept and its judicially-widened definition, minority shareholders would otherwise have no cause of action and no ground to bring a lawsuit since these actions are beyond the illegality and fraud theories.⁶³

The issues of minority shareholders—the absence of the ready market, the owners' expectations, and the dilution of ownership interests— have all together paved the way for the

⁶⁰ See J. A. C. Hetherington, *Defining the Scope of Controlling Shareholders' Fiduciary Responsibilities*, 22 WAKE FOREST L. REV. 9, 40 (1987) (drawing a distinction among the terms fraud, illegality, and oppression. On the one hand "illegality and fraud are terms with relatively clear legal meanings and include violations of statutory requirements and misappropriations of corporate assets." On the other hand, "[oppression] must refer to conduct not embraced by either of these terms.")

⁶¹ Another distinction between fraud and illegality on the one hand and oppression of the other is that the former appears to be directed at only "the shareholder's investment in the corporation," while oppression is directed at the shareholder himself. See Pinto, *Protection in the U.S.* at footnote 79.

⁶² In the famous case *Matter of Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1180 (N.Y. 1984), the court sets a test for what may constitutes oppression, stating that "[defining oppressive conduct] has been resolved by considering oppressive actions to refer to conduct that substantially defeats the "reasonable expectations" held by minority shareholders in committing their capital to the particular enterprise . . . A shareholder who reasonably expected that ownership in the corporation would entitle him or her to a job, a share of corporate earnings, a place in corporate management, or some other form of security, would be oppressed in an authentic sense when others in the corporation seek to defeat those expectations." See also *McLaughlin v. Schenck*, 220 P.3d 146, 150 (Utah 2009), which ruled that the shareholder majority owes a duty of "utmost faith" to the minority counterpart.

⁶³ Some scholars who have been influenced by law and economics, "dominant mode of corporate scholarships," have criticized the common use of "reasonable expectations" criterion by courts of almost all states across the United States, except Delaware, Kansas, and Oklahoma, which have turned down the exceptional protection for minority shareholders in close corporations. See DEL. CODE ANN. tit. 8, § 273 (1991); KAN. STAT. ANN. § 17-6804(d) (1988); OKLA. STAT. ANN. tit. 18 § 1094 (West 1987). Generally See, Benjamin Means, *A Contractual Approach to Shareholder Oppression Law*, 79 FORDHAM L. REV. 1161, 1163 (2010); Douglas K. Moll, *Reasonable Expectations v. Implied-in-Fact Contracts: Is the Shareholder Oppression Doctrine Needed?*, 42 B.C. L. REV. 989, 1002 (2001) (spotting the increase use of reasonable expectations standard); Jon Hanson & David Yosifon, *The Situation: An Introduction to the Situational Character, Critical Realism, Power Economics, and Deep Capture*, 152 U. PA. L. REV. 129, 142 (2003) (Defending the longstanding employment of law and economics as a " dominant theoretical paradigm" to perceive and evaluate law and policy). See, e.g., *Nixon v. Blackwell*, 626 A.2d 1366, 1379–81 (Del. 1993); *Richards v. Bryan*, 879 P.2d 638, 648 (Kan. Ct. App. 1994).

majority to engage in oppressive conduct. The oppression of minority shareholders may strike by limitless devices that can be cataloged into two categories in conjunction with the on-ground consequence each technique generates: squeeze-out and freeze-out devices. The squeeze-out devices are actions that are taken by the majority to remove the unwelcome minority. Such actions include merger consolidation,⁶⁴ dissolution, and compulsory share exchange.⁶⁵

The second category includes devices that deprive the minority of any return on their investments or exit the company for a fair price for their interests. These devices lock the minority in the company, divest them of their voice in the corporation management, and freeze their interests. Such actions include withholding of dividends, paying high compensations to the managers and officers of the majority shareholders,⁶⁶ siphoning off corporate assets,⁶⁷ abusing share issuance rights, and the misappropriating corporate opportunity.⁶⁸

⁶⁴ The merger is an effective procedure that is deemed to be useful to get rid of the minority shareholders. *See, e.g.,* Matteson v. Ziebarth, 40 Wash. 2d 286, 242 P.2d 1025 (1952).

⁶⁵ *Accord* F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS ch.1, § 1.01, at 1 (2d ed. 1997) (defining oppressive conduct as "the use by some of the owners or participants in a business enterprise of strategic position, inside information, or powers of control, or the utilization of some legal device or technique, to eliminate from the enterprise one or more of its owners or participants." The authors go further to subcategorize squeeze-outs to "partial squeeze-outs" and define them as mechanisms that "reduces the participation or powers of a group of participants in the enterprise, diminishes their claims or earnings or assets, or otherwise deprives them of business income or advantages to which they are entitled." *See Id.* at 1–2, (discussing a partial squeeze-out).

⁶⁶ Large remunerations for directors and officers coupled with the refusal to declare dividends establish a cause of action and claim for relief. *See* O'Neal & Moeling, Michigan Close Corporations, footnote 42.

⁶⁷ In many cases, majority shareholders execute a contract between the corporation and another corporation they own to drain the corporation's assets; *see* O'Neal & Moeling, Michigan Close Corporations at 734. another way to deploy the corporation's monetary resources is "[by] form of high salaries or rents, insulated from judicial review by the business judgment rule." *See* Thompson, Cause of Action at 703.

⁶⁸ For detailed freeze-outs devices such as management buyouts, short-form mergers, and reverse stock splits, *see* Julian Javier Garza, *Rethinking Corporate Governance: The Role of Minority Shareholders - A Comparative Study*, 31 ST. MARY'S L.J. 613, 622–625 (2000); 2 F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS ch.8, § 8.13, at 67–68 (3d ed. 1998); JAMES D. COX ET AL., CORPORATIONS § 23.2, at 611 (1997).

Along with the negative impacts on the business generated by the oppressive conduct, disputes and dissension among the owners also produce negative publicity that makes potential investors hearing about the oppressive conduct inside the corporation shun investing in it.⁶⁹

Part III. Strategies to Protect the Minority Shareholders

Overview

The issues of minority shareholders in close corporations are addressed differently by each state and country. However, the approaches to solving the minority conundrum can be narrowed down into three strategies: the legislative strategy, the judicial strategy, and the contractual strategy.

Moreover, the timing of these strategies plays a pivotal role in the investment decisions as individuals advance and risk some of their fortunes in expectation of a job or role in the corporate management along with returns on their investments in the business.⁷⁰

For instance, the contractual strategy or the contractual protection of minority shareholders is an ex ante approach, as shareholders together decide (in advance and before committing their money for the sake of the business) on the provisions that redesign the corporation's default features in order to make it more suitable to meet their own needs.

On the contrary, the judicial strategy serves as ex post protection for minority shareholders. Grieved shareholders afflicted by oppressive conduct by opportunistic majority shareholders demand justice and ask for oppression to be lifted. Flip thinking of the judicial protection shows that even if the role of the judiciary appears after the occurrence of the dispute, lawyers and

⁶⁹ See O'Neal & Moeling, Michigan Close Corporations at 731.

⁷⁰ See Thompson, Cause of Action at 702, (arguing that close corporations as described intimate enterprises are not only channels for investments of monetary contributions in the capital, but also an opportunity for the investment of human capital).

counselors drafting bylaws, shareholder agreements, or other organizational documents may benefit from the existing rules to anticipate potential issues their clients may encounter down the road.⁷¹

The legislative strategy, or so-called statutory protection, embraces the protection for the minority shareholders both *ex ante* and *ex post*. Note that both *ex ante* and *ex post* forms of protection predate the incorporation of an entity; the statutory protection is already out there in the form of corporate law, regulation, supplement, or statute. However, these statutory protective provisions may be classified based on the nature of the subject matter to which each rule or article is applicable. For example, articles concerning the operation of the board of directors, the regulations of shareholder assemblies and share issuance are thought to be *ex ante*, as they aim at ensuring the minimum requirements for healthy operation of the company. The *ex post* protection for the minority shareholders is a mixture of rules and articles that take place after the occurrence of disputed conduct, such as oppression or the criminal accountability of corporate officers in intentional mismanagement. Such misconduct triggers the related rules and thus bring into the arena the *ex post* role of the judiciary.

In sum, the protection of minority shareholders can be divided into three sorts based on what each strategy yields: statutory protection, judicial protection, and contractual protection.

⁷¹ The researcher is of the opinion that lawyers in the United States, for example, have a crystal image of the judicial treatment for minority shareholder's oppression due to the massive literature and legal scholarships of the subject matter, as well as the large body of case precedent to rely upon. In contrast, it seems to be challenging for lawyers practicing in Saudi Arabia to have a clear perception about the treatment of the Saudi Judiciary due to many factors, such as the shortage publications of courts' rulings in the subject matter and the novelty of the statute concerning it. Therefore, it still seems that the judicial approach in Saudi Arabia lacks the *ex ante* protection that may be found in the United States or other jurisdictions.

A. The Statutory Protection

In reviewing the statutory protection of minority shareholders across several jurisdictions, one can conclude that corporate laws along with other related regulations vary in their degrees of protecting minority shareholders.⁷² Some jurisdictions offer a greater protective system for the minority, as opposed to the ones with limited legislative resources for minority shareholder protection. The forms of legislative protection may be signified in the adoption of strong corporate governance practices, the special statutory treatment for close corporations, the approval of the heightened duties upon majority shareholders, statutory remedies, the mandatory buyouts, and the statutory criminalization of the abuse of power and mismanagement by directors and officers. All of which are indicators that are utilized to determine whether an X jurisdiction is more or less favorable to protect its minority shareholders.⁷³

1. Strengthening Corporate Governance and Boosting Shareholder's Rights

The Statutory adoption of good corporate governance rules confidently enhances the protection for minority shareholders in close corporations.⁷⁴ Such an adoption should be followed by vigorous enforcement of the statutory shareholder rights stipulated in corporate laws. However, these rights

⁷² See, e.g., Matheson & Maler, Simple Solution at 700, (conducting a comprehensive state-by-state analysis of the minority shareholder protection premised upon both cases ruled by courts and statutes and laws enacted by legislatures regarding oppression in fifty states).

⁷³ This statutory approach has, nevertheless, received some criticism. According to the opposite side, statutory protection is overreaching and extends its protection for the minority shareholders who did not contract for such protection. See Arthur R. Pinto, *Protection of Close Corporation Minority Shareholders in the United States*, 62 AM. J. COMP. L. SUPP. 361, 370, 376 (2014) (criticizing the statutory approach as it “could undermine private ordering, the freedom to bargain, and the important role of contracting ex ante for protection and the most efficient results).

⁷⁴ See Julian Javier Garza, *Rethinking Corporate Governance: The Role of Minority Shareholders - A Comparative Study*, 31 ST. MARY'S L.J. 613, 696 (2000) (“Minority shareholders may not control the company, but their role in a corporation through minority rights, fiduciary duties, requirements of fair dealing and good faith, private agreements, and derivative suits influences corporate governance and makes minority shareholders significant players in the corporate world.”)

vary in conjunction with the legislatures' desires and how far they are willing to go to protect the minority shareholders and improve their positions.

Several rights and rules enshrined in the corporate law can mirror the robustness of its corporate governance and its stand for minority shareholders. Some of these rules, for instance, are the adoption of the cumulative voting system, the statutory shareholder meeting, the separation between the chairperson and the C.E.O, and the constraints on the number and duration of the members of the board.

2. Special Statutory Treatment for Close Corporations

Another indicator of strong statutory protection for minority shareholders comes from the special treatment that close corporations enjoy in some jurisdictions. For a long time, legislative bodies in most jurisdictions have deviated the fact that close corporations are of special nature and thus should not be dealt with as public corporations.

In response, a number of jurisdictions have enacted some special rules and regulations that are well-designed to satisfy the increasing needs of close corporations. These regulations and supplements often provide tailored corporate governance rules that suit the nature of the close corporations.

3. Statutory Remedies

a. Dissolution

Dissolution is widely listed in most states' dissolution laws as "the principal vehicle used by legislatures, courts, and litigants to address the particular needs of close corporations."⁷⁵ Most states offer the minority statutory grounds based upon which it may seek dissolution of the

⁷⁵ See Thompson, Cause of Action at 709.

corporation.⁷⁶ Nevertheless, courts have differed in the circumstances under which they grant this harsh remedy as corporate statutes lay various grounds for judicial dissolution.⁷⁷

b. Alternative Remedies

With respect to the severity of involuntary dissolution and in avoidance of such an extreme remedy,⁷⁸ legislatures have provided courts with greater flexibility to impose less drastic remedies in oppression cases for on-going businesses (instead of these viable businesses' being wrecked by dissolution). The courts, in turn, are more inclined to grant alternative reliefs short of dissolution.⁷⁹ Some alternative reliefs that corporate statutes make available to the courts are the appointment of the custodian, reorganization of the corporation's charter and bylaws, or a forced buy-out.

One of the judicially-applied alternative remedies is mandatory buyouts.⁸⁰ The buy-out provision forces corporations to buy the shareholding of the complaining shareholder at a fair market price. Some courts may order a buy-out even in the absence of statutory or judicial

⁷⁶ Except in Delaware, Kansas, and Oklahoma states, these states deny the involuntary dissolution of a close corporation unless it has two shareholders with equally divided ownership interests. *See supra* note 63. Note that these three states have adopted alternative remedies to solve the dilemma of minority shareholder oppression. Such an alternative is the appointment of custodians. Also, Delaware and Kansas have special statutes for close corporations that offer additional remedies, if the corporation elects the close corporation status. *See Thompson, Cause of Action* at 709.

⁷⁷ *See, e.g., Rogers, Alaska Close Corporations* at 58, (A minority shareholder may sue based on the available grounds for dissolution, which "[includes]: (1) that the majority has engaged in the gross misconduct []; (2) that there is deadlock; and, (3) in the case of corporations with fewer than thirty-five shareholders." Dissolution is reasonably necessary for the protection of the rights or interests of the complaining shareholders.)

⁷⁸ *See Matthew C. Lucas, Revoking the Irrevocable Buyout: Aligning Equity with Due Diligence in Corporate Dissolution*, 75 ALB. L. REV. 15, 15 (2011) (referring dissolution of the business as "one of the most acrimonious, expensive, and, by almost all accounts, unpopular of legal remedies available in business litigation.")

⁷⁹ Some of the alternative remedies include changes or cancelation of any provision of the incorporation's articles, the bylaws, corporate decisions, the sale of the corporate property and franchises of the corporation to a specific purchaser, removing officers or directors, requiring an accounting, or ordering payment of dividends or damages. *See, e.g., The Model Statutory Close Corporation Supplement*, embraced by several states, has nine examples of remedies.

⁸⁰ *See, e.g., Matheson & Maler, Simple Solution*, at 665, (asserting that a "buyout of the complaining shareholder's shares is also the rule in eighty percent of the states: about forty states provide this remedy, either through statute or through common law.")

authorization, or even in the absence of a request to the court by the corporation or a majority shareholder.

4. The Statutory Criminalization

Another statutory approach to protect the corporation and the interests of its shareholders is the statutory criminalization of some malfeasance by corporate officers and directors. Criminalizing misconduct acts as a deterrence, especially when it entails severe penalties, such as fines, incarceration or both.⁸¹

B. The Judicial Protection

Courtrooms are the battlefields for the oppressed to restore justice and have some sense of fairness as the management of their corporations along with their business partners deprives them of their rights. This puts a burden upon the courts to re-balance the relationships between the owners in light of the special nature of the close corporations on the one hand, and the fairness and equity principles on the other.

The courts play an indispensable role in promoting justice and fashioning doctrines and rules that are applicable to close corporations, while legislatures might have overlooked the differences between public corporations and close corporations in drafting corporate statutes and codes. In the United States, for instance, courts across the country have given birth to several judicially-created doctrines and principles that fill the gaps the legislative left in the handling of the close corporations.⁸² They have always intermeshed laws with the altering business atmosphere.

⁸¹ It will be thoroughly analyzed later in this research.

⁸² This claim, however, is not without controversy; the Delaware Supreme Court in *Nixon v. Blackwell* ruled against the creation of judicial doctrine to shelter minority shareholders from oppression, and asserted that it is within the legislative branch to formulate such a doctrine or rule. *See Matheson & Maler, Simple Solution* at 663.

Along with Common law, some state legislatures have empowered courts with an array of delegations over the close corporation matters. For example, defining oppression as a cause of action,⁸³ and imposing statutory remedies such as dissolution, buyouts, and the assignment of a receiver or custodian. Some courts have even gone beyond the statutory functions (and sometimes authorization)⁸⁴ assigned to them in the protection of minority shareholders, so they manufactured the heightened partnership duty on majority shareholders, in addition to the conventional corporate duties of care and loyalty owed by majority shareholders, as directors and officers, to the corporation.

The Heightened Partnership Duty upon Majority Shareholders

A number of U.S. courts have adopted an enhanced duty that a close corporation majority, in its shareholder's capacity, owes the minority shareholders a heightened duty of care akin to the duty upon partners in the partnership, where the relationship between partners is of "utmost good faith"⁸⁵ and trust and confidence.⁸⁶ Judges have become more inclined to broaden the minority shareholders' ability to file a direct cause of action against the majority's breach of duty.⁸⁷

The birth of the partner-like fiduciary duty offers a greater extent of protection for the minority shareholders because this sort of protection is assumed to be tailored to any given circumstances, in aid for the trapped and oppressed minority shareholders.⁸⁸ To find a breach of this duty is a

⁸³ See the discussion about oppression and the U.S. judicial definition in § II, D.

⁸⁴ See Thompson, Cause of Action, footnote 70, (emphasizing that courts lean to grant alternative remedies even in the absence of legislative ground or statutory authorization to grant a remedy).

⁸⁵ James M. Jr. Van Vliet & Mark D. Snider, *The Evolving Fiduciary Duty Solution for Shareholders Caught in a Closely Held Corporation Trap*, 18 N. ILL. U. L. REV. 239, 252 (1998) (referring to the heightened duty of shareholders as a "golden rule" in a corporate setting).

⁸⁶ See, e.g., *McLaughlin v. Schenck*, 220 P.3d 146, 150 (Utah 2009) (confirming that minority shareholders are owed a fiduciary duty of "utmost good faith"); *Donahue v. Rodd Electrotypes Co.*, 328 N.E.2d 505, 512 (Mass. 1975) ("Just as in a partnership, the relationship among the stockholders must be one of trust, confidence and absolute loyalty if the enterprise is to succeed.")

⁸⁷ *supra* note 84.

⁸⁸ *Id.*

question of facts, yet the breach of the duty in close corporations oftentimes arises out of the disproportionate treatment against the minority, the frustration of its reasonable expectations, or the freeze-out or squeeze-out action.⁸⁹ Without a heightened duty, some conduct may be considered oppressive, unfair to the minority, yet their legality would be undoubted if courts examined the action under the ordinary duties of care and loyalty.⁹⁰

However, the degree of the protection afforded to the minority shareholders by the judiciary (by its broadened definition of oppression or the creation of the enhanced duty) has received a great deal of criticism, namely by the advocates of the contractarian view and the scholars of law and economics. An optimal level of protection for minority shareholders, they contend, is reached by shareholder's contracting ex ante.

C. Contractual Protection

In the view of contractarians,⁹¹ the corporation is a nexus of contracts into which individuals out of their own free will enter.⁹² In this context, shareholders should contract for their protection.

⁸⁹ For further thorough illustration of the three categories and U.S. authorities on the subject matter, *See Id.* 525–561.

⁹⁰ In opposition to this claim, another competing viewpoint, in accordance to standard law and economics, argues that imposing an additional duty upon the majority shareholders factually wrongly empowers the minority with an additional weapon, and the understanding of close corporations in Delaware will eventually dominate in the corporate law. Instead, shareholders are better protected by contracting ex ante. For an insightful look at this counterargument, see Mary Siegel, *Fiduciary Duty Myths in Close Corporate Law*, 29 DEL. J. CORP. L. 377, 490 (2004).

⁹¹ *See* Benjamin Means, *A Contractual Approach to Shareholder Oppression Law*, 79 FORDHAM L. REV. 1161 (2011) (citing contractarians as those who “view corporate law as simply a modest extension of contract law.”); John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1619 (1989).

⁹² *See* STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 830 (2002) (asserting that a corporation is a “web of explicit and implicit contracts establishing rights and obligations . . .”); Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 779–80 (2006).

Contracting before investing is often believed to be the best approach for the minority shareholders to guarantee their rights, safeguard their expectations, and preclude the shareholder opportunism.⁹³

The contractual protection for minority shareholders comes in a variety of devices that are tailored to meet the expectations of shareholders and affirmatively shield them from opportunistic or oppressive conduct. Some predominant devices commonly used in the protection of the shareholder expectations are shareholder agreement, long-term employment contract, and the incorporation of protective provisions in the corporation bylaws and charter.⁹⁴

1. Shareholder Agreement

The shareholder agreement is a prominent device to protect the interests of not only the minority shareholders but also the majority ones.⁹⁵ It is a contract frequently utilized in support of the efficient and sustainable operation of the firm. Moreover, it serves as a gap-filling device for the loopholes that are left unfilled by the legislation.⁹⁶ To keep up with the rapidity norm of the business, contracts are undoubtedly faster to respond to corporate contingencies than enacting new laws or amending current ones.⁹⁷

⁹³ For insightful discussion about the contractual approach to shareholder protection, see Paula J. Dalley, *The Misguided Doctrine of Stockholder Fiduciary Duties*, 33 HOFSTRA L. REV. 175, 221 (2004) (opposing the courts' intervention as it may "rewrite the contract and provide a windfall to the minority"); FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 229 (1991) (emphasizing the importance of contractual devices to ensure the flow of returns on investments); STEPHEN M. BAINBRIDGE, *CORPORATION LAW AND ECONOMICS* 830 (2002) (stating that shareholders who desire more freedom to dissolve the corporations should bargain for such a right before investing).

⁹⁴ F. HODGE O'NEAL, "SQUEEZE-OUTS" OF MINORITY SHAREHOLDERS – EXPULSION OR OPPRESSION OF BUSINESS ASSOCIATES (1975)

⁹⁵ A consensual shareholders' agreement represents a comprehensive understanding among all shareholders about the expectations of each one of them before they embark upon a business.

⁹⁶ See Charles R. Jr. O'Kelley, *Filling Gaps in the Close Corporation Contract: A Transaction Cost Analysis*, 87 NW. U. L. REV. 216, 253 (1992) ("The close corporation contract assigns primary gap-filling authority to majority shareholders, and gives secondary, discretionary gap-filling authority to courts.")

⁹⁷ See F. Hodge O'Neal, *Oppression of Minority Shareholders: Protecting Minority Rights*, 35 CLEV. ST. L. REV. 121, 143–146 (1987).

Drafting such a contract requires in-depth knowledge of the existing corporate-related laws and case laws, as well as skills to extrapolate the future from the status quo of the would-be business partners.⁹⁸ Many of the business partners' clashes and conflicts are negative outcomes following shareholders' oblivion to what awaits them down the road.⁹⁹ At the outset of the business, shareholders are often short-sighted as they fail to apprehend the potential struggles and oppression in the absence of the protective provisions beforehand.¹⁰⁰

For a robust protective shareholder agreement, attorneys and legal practitioners are well-suited to perform such work. It is exceedingly advised that soon-to-be shareholders should have their legal representatives draft and review this agreement before they are bound to it. Such representatives are widely acquainted with the regulatory framework of the corporations, and more familiar with the judicial decisions involving a close corporation's wrangle. They shoulder the burden to examine shareholders and figure out any potential dissension that may occur during the lifetime of the corporation.¹⁰¹

The protection of minority shareholders through the shareholder agreement comes in forms of a non-exhaustive list of protective and preventive provisions and clauses that can be fashioned to meet the shareholders' needs case-by-case. Such clauses are, for instance, veto power, restriction on the transfer of shares, and a choice of law clause.¹⁰² It is of the attorneys' duty to point out to shareholders the consequences of each provision, such as the advantages and disadvantages of the

⁹⁸ *Id.*

⁹⁹ *See infra* note 107.

¹⁰⁰ *See infra* note 107.

¹⁰¹ Molano Leon, Ricardo, *Shareholders' Agreements in Close Corporations and Their Enforcement*, the Student Works and Orgs. at Digital Commons, Georgia Law, paper. 89 (2006).

¹⁰² *Supra* note 97.

provision and any substitutional course of action as well as the problems it entails in a court of law.¹⁰³

2. Long-Term Employment Contract

In return on their capital investments, shareholders expect to occupy salaried positions in their corporations. A well-fashioned employment contract can fence such an expectation in a precaution against exclusion or deprivation of working for the corporation.¹⁰⁴ To have a protective employment contract, shareholders are advised to tie part of their remunerations with the prosperity of the corporation in the form of, for example, bounces or percentages of profits. Another protective clause is one that guards the shareholder-employee against any oppressive termination of employment, failure to renew the contract or breach of it. Examples of this sort of clause are liquidated damages, severance package, mandatory offer to purchase the shareholder's shares or a lifetime pension.¹⁰⁵

3. Protective Provisions in Corporate Charters and Bylaws

Another contractual approach to effective protection for the minority shareholders is to include the corporate charters and bylaws some provisions that ensure the minority shareholder's participation in the management and decision-making.¹⁰⁶ Such a provision is the unanimity or super-majority vote requirement for appointing the members of the board or deciding on fundamental corporate actions (e.g., mergers and share issuance). These provisions implicitly embolden shareholders to veto opportunistic transactions. To back up these provisions, minority shareholders should be continuously represented in the board of directors to exercise their

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

bargained-for rights, which can be attained by, for example, the share classification and the staggered board provision.

Tackling close corporation issues beforehand through contracting may sound ideal on the book, yet this is not always the case in the world of close corporations, which are dominantly owned by family or people sharing interpersonal bonds.¹⁰⁷ In reality, the enthusiasm to commence the business with blind trust among shareholders hypnotizes them so that they cannot foresee anything but success and a lucrative business ahead.¹⁰⁸ Furthermore, minority shareholders at the kickoff of a business often lack the bargaining power to contract for their rights. Also, this approach requires minority shareholders to squander much time and bear high costs.¹⁰⁹ In addition, contracts demand reliability upon the judiciary to construe and enforce them, yet the judicial bodies of developing countries at large still run behind the rapidly-developed business sector, including corporations.¹¹⁰ Therefore, this infers that vigorous interventions by the statutory and judicial branches to monitor and keep corporations in check are of great necessity.¹¹¹

¹⁰⁷ See LARRY E. RIBSTEIN, *THE RISE OF THE UNCORPORATION* 108 (2010) (stating that shareholders of close corporation oftentimes “lack either the foresight to plan for the breakdown of their relationship, or could not easily figure out how to balance the dangers of freeze-in against the risk that a member would use a power to dissolve the corporation to oust a comember.”); Benjamin Means, *A Contractual Approach to Shareholder Oppression Law*, 79 *FORDHAM L. REV.* 1163 (2011) (“[F]ellow investors are often family members or friends. It should come as no surprise, therefore, that investors often fail to anticipate and bargain against future oppression, especially regarding problems that may not surface until later generations assume control of the business.”)

¹⁰⁸ *Id.*

¹⁰⁹ *Id.* at 1164, (claiming that “if an investor has plenty of both, and thinks added clarity is worth the bother, there is a limit to what can be effectively dealt with ahead of time”).

¹¹⁰ See, e.g., Bernard S. Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 *HARV. L. REV.* 1911 (1996) ([A] company law that depends on fast and reliable judicial decisions is simply out of the question in many emerging markets.); John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 *COLUM. L. REV.* 1618, 1620 (1989) (contending that long-term contract requires “judicial involvement[that] is not an aberration but an integral part of such contracting”). Coffee characterizes the judicial monitoring as a “key tradeoff” in that “we counterbalance contractual freedom with ex post judicial review.” *Id.* at 1621.

¹¹¹ See Benjamin Means, *A Contractual Approach to Shareholder Oppression Law*, 79 *FORDHAM L. REV.* 1163 (2011) (“In a long-term contract rife with gaps that a party can exploit to further its own interests at

In sum, if the minority shareholders fail to defend their expectations and protect their own interests through bargaining for their rights,¹¹² they still should be sheltered by a protective legislature and judiciary. Even if each approach has its role, they all work hand in hand to serve the trapped minority shareholders and their interests in close corporations in conjunction with the corporate norms.

Conclusion

Although the terminology of minority shareholders and close corporations breed confusion, it is of importance to settle upon the meaning of these terms throughout the research as they describe shareholders with no power over the management of the corporation that is unlisted on a securities market. This definition of minority shareholders and close corporations offers a broader meaning since it is not only limited to who owns less than a half of the capital but also it embraces shareholders who have majority ownership interests but lack the power over the corporation's administration. In addition, it encompasses close corporations that would not have the close status under the numerical limit on shareholders.

Worldwide, the close corporation's structure has often caused inherent difficulties for some shareholders. The minority shareholders often fear being trapped in a corporation whose shares are not freely alienable. Furthermore, these shareholders commonly expect to occupy a managerial capacity as it is the primary source of return on their investments. Such expectations, however, are often frustrated unless they are bargained-for. Also, the special feature of centralized management

the expense of the other parties to the agreement, the possibility of bad-faith opportunism¹² is ever-present and robust judicial monitoring seems not only helpful, but necessary.”)

¹¹² See Robert B. Thompson, *The Law's Limits on Contracts in a Corporation*, 15 J. CORP. L. 377, 394 (1990) (highlighting the significance of the judicial branch in shareholders' arrangements as “a close corporation is like a long-term relational contract in which benefits for all parties necessarily depend on unstated assumptions. A fully contingent contract cannot be drafted, so some ex post settling up by courts is used to support these assumptions”).

may lure majority shareholders into engaging in oppressive or opportunistic conduct against others. These widespread issues of minority shareholders in closely held company call for the intervention to rectify the minority's situation.

In response to the those above and in protection of the vulnerable standing of the minority shareholders, the legislative and judicial branches have intervened to recognize the distinctive needs of the close corporations and the knotty problems they pose. This recognition comes in a variety of forms (such as the judicially-developed "reasonable expectation" standard in the U.S. or the special statutory supplement designed for close corporations) to ultimately protect the minority and curb any abusive conduct by the majority. These curative interventions come as some minorities fail to protect their expectations and prevent any potential misconduct and oppression against the minority through ex ante contracting. The contractual approach is another device to address minority shareholder problems, yet such an approach is less effective in the absence of equal bargaining power among parties.

Chapter Two: Corporate Laws and Regulations of Business Organizations in Saudi Arabia

“Laws should be like clothes. They should be made to fit the people they are meant to serve.”

Clarence Darrow

Motivating Hypothetical

After Saad realizes the issues associated with his father’s offer and the complexity of the corporation structure, he is now wondering how corporations operate in Saudi Arabia, and by what laws and regulations his father and he will be bound. Before jumping into the internal legal system of the corporation, he wants to learn about the regulatory framework governing the corporation and be educated about how public companies differ from close ones.

The Scope of Chapter Two

This chapter aims at delineating the corporate arena in Saudi Arabia and sets up the legal ground upon which the corporation is incorporated and regulated. It is divided into two sections. The first section offers a comprehensive overview of the legal structure governing Saudi corporations. This includes a historical snapshot of the inception and the developments of the Saudi corporate laws and regulations. The second section maps out the unique structure of the ownership in the region. This encapsulates, on the one hand, the ownership structure of publicly-traded corporations (including state-controlled corporations, and family-controlled corporations) and the ownership structure of closely held corporations by state and family, on the other hand.

Part I. Laws and Regulations of Saudi Corporations

A. Principal Laws

1. The Commercial Court Law (CCL)

In 1931 and before the unification of the Kingdom, the Commercial Court Law launched the advent of regulating commerce in the region.¹¹³ It consists of 633 articles that govern a range of commercial activities, such as the bills of exchange, maritime commerce, and the corporation.¹¹⁴ Only seven out of 633 articles were cut to regulate corporations. These articles provided no elaborate guidelines but the types of business organizations it considered lawful at that time.¹¹⁵ The deficiency of the CCL to regulate broad aspects of corporate activities (e.g., the incorporation, the governance, the dissolution, and the liquidation) alongside the growing number of the companies necessitated the enactment of a new and separate law recognizing the recent socioeconomic developments.¹¹⁶

2. The Companies Law of 1965

In response to the call of modernization following the oil discovery in the region and the absence of governing rules for corporations, the state issued its first-ever corporate law to regulate

¹¹³ The founder of the Third Kingdom, King Abdulaziz, promulgated the Commercial Court Law on the second of June of 1931 by royal decree No. 32. This Law was mainly drawn on its French counterpart, and “... was among other civil, maritime, criminal and civil and criminal [sic] procedural legal changes brought about in the [nineteenth].” See AlMajid at 174. See Also George N. Sfeir, *The Saudi Approach to Law Reform*, 36 AM. J. COMP. L. 729, 730 (1988).

¹¹⁴ AlMajid, at 174.

¹¹⁵ These organizations included general partnership, limited liability partnership and joint-stock corporation. See AlMajid, at 176 (attributing the adoption of these organizations to their origin in the Islamic literature).

¹¹⁶ *Id.* (asserting that even though the Law is still “valid in principle”, a bunch of its articles and rules were superseded by more specialized statutes and laws in different areas. For example, companies law, negotiable instruments, and “other single-purpose regulations with limited competence and scope”).

all sorts of organizations existing at that time.¹¹⁷ It raised the number of forms of organizations allowed to operate to seven.¹¹⁸ Like other Saudi laws and regulations at that phase, the Law copied virtually the Egyptian Companies Act, which was fashioned after the French Companies Code.¹¹⁹ Emphasis should be added that the Law affirmed strict conformity with Sharia in implementing the Law.¹²⁰

In a nutshell, the law comprised of 233 articles formulating the regulatory framework for all organizations in the region, including the close corporations—principal to the present thesis. Chapter five of the Law regulated all aspects of joint-stock corporations (close and public) in 100 articles.¹²¹ Such aspects were the incorporation, shareholder meetings, shareholder rights, merger rules, and public offerings. It also embraced a modest level of corporate governance principles in terms of the corporation's internal institutions, involving the board of directors' responsibilities and duties.¹²² Overall, the Law was argued to have complied with half of the corporate governance guidelines recommended by the Institution of International Finance.¹²³

¹¹⁷ *Id.* n. 618, (questioning the lengthy period (around 34 years) the Saudi legislator took to realize the insufficiency of the Commercial Court Law to regulate companies in the region, and claiming that discovery of oil laid the foundation for a new era for economic, financial, and social changes).

¹¹⁸ In addition to the business organizations listed in note 115, the Law included in mutual partnership, limited liability company, syndicate company, and company limited by shares. *See* Article two of the Companies Law of 1965.

¹¹⁹ Compare AlMajid, at 177 with Bandar O. Alrasheed, *Corporate Governance of The Saudi Arabian Publicly Traded Companies: an Appraisal and Proposals for Improvement*, p.64 (2014) (Unpublished SJD dissertation, University of Pittsburgh) [hereinafter Alrasheed] (on file with the author) (claiming that the business culture in the region is American-oriented, and attributing that to “the pioneer oil prospecting concession granted to [an] American oil company and the unique political alliance and economic partnership between the United States and the Kingdom of Saudi Arabia”).

¹²⁰ *E.g.*, Article two of the 1965 Companies Law declared that “[w]ithout prejudice to such companies known in Islamic jurisprudence, any company that does not assume one of the mentioned forms shall be considered null and void, and the persons who have made contracts in its name shall be personally and jointly liable for the obligations arising from such a contract.” Notice that the article exempted companies recognized by Sharia from assuming a form of the seven enumerated in the Law without being nulled.

¹²¹ Articles 48–148.

¹²² For further insight, see Youseif A. Alzahrani, *Rights of Shareholders under Saudi Company Law 1965* (2013) (Unpublished Ph.D. dissertation, Brunel University) (on file with the author).

¹²³ Alrasheed, n. 11 at 3.

The Law underwent several amendments during its lifespan. However, the forty-four-year-old could not withhold the bitter criticism about its deficiency and its failure to meet the demands of the modern market. What served the country in 1965 and during the transition period became incompetent to stand in an era of large-scale financial connectivity and volatility. That resulted in the fact that many corporate matters were regulated by scattered ministerial ordinances and circulars.¹²⁴ In addition, the introduction of the Capital Market Law¹²⁵ and the formation of the Capital Market Authority abridged the Companies Law's jurisdiction over public corporations.¹²⁶

3. The Capital Market Law of 2003 and the Accompanying Rules

Earlier before the passing of the Capital Market Law, the securities market¹²⁷ had been regulated in an ad hoc approach that did not correspond with the increase in the economy and the governmental trend to enhance the private sector.¹²⁸ The market was subject to various regulations, every one of which was intended to attain different ends, but holistically they aimed at regulating the market in principle. Not to mention the overlap among ill-defined authorities in charge of

¹²⁴ AlMajid, at 177, 180.

¹²⁵ See *infra* Chapter 2. Part I. A. 3.

¹²⁶ AlMajid, at 179.

¹²⁷ It is claimed that the beginning of the modern trading system for shares is traced back to two occasions: first, the establishment of a ministerial committee, comprised the Minister of Finance, the Minister of Commerce and the Governor of Saudi Arabian Monetary Agency, and responsible for almost all security-related activities, such as establishing a share-trading system and supervising it, by Royal decree No1230/8, on April 24th, 1983. The second was the establishment of the Saudi Share Registration Company, in charge of administering shareholders' records, share certificates, and facilitating the transferring of share ownership. For further history about the inception of Saudi securities market, See FAHAD M. ALMAJID, *A CONCEPTUAL LEGAL FRAMEWORK FOR REFORMING SAUDI CORPORATE GOVERNANCE*, p. 180–184, Lambert Academic Publishing (2014); Sultan Alabdulkarim, *An Evaluation of Investors Protection in Secondary Securities Market: A Comparative Study of Regulatory Regimes in the United Kingdom and Saudi Arabia*, p.248–254 (2012) (Unpublished Ph.D. dissertation, Newcastle University) (on file with the author); Mohammed T. Alsanosi, *Corporate Governance: The Saudi Arabian Capital Market and International Standards*, Ch.4 (2010) (Unpublished Ph.D. dissertation, University of Leicester) (on file with the author).

¹²⁸ Sultan Alabdulkarim, *An Evaluation of Investors Protection in Secondary Securities Market: A Comparative Study of Regulatory Regimes in the United Kingdom and Saudi Arabia*, p. 248–254 (2012) (Unpublished Ph.D. dissertation, Newcastle University) (on file with the author) [hereinafter Alabdulkarim].

fulfilling their creation's purposes made it difficult for foreign investors to risk their capitals in such a market.

As the economy was growing, and the necessity to attract direct foreign investments was escalating, the country sensed the need for a more explicit, yet comprehensive legal framework that would gain the trust and confidence of investors, mainly foreign ones.¹²⁹ Evidently, economic changes, as argued, precede legal developments.¹³⁰ While the economic and financial sources abounded in the region, the country suffered from a scarcity of regulatory foundations.

Therefore, in 2003 the country introduced a significant piece of legislation that crafted the foundation for a new world for investments in the Saudi securities market.¹³¹ The Capital Market Law passage marked the end of chaotic sittings deterring the entry of foreign capitals and blocking the prosperity of the Saudi economy.

The sixty-seven-article Law guarantees flexibility and efficiency of the market. To do so, a governmental authority with financial, administrative autonomy was created as enshrined in article four of the Law.¹³² Moreover, to promote the protection for investors and shareholders, the Law ordered the establishment of the Committee for the Resolution of Securities Disputes.¹³³

In exercise of its power, the board of the Capital Market Authority, since its establishment, has issued a cluster of rules and implementing regulations controlling the market, listed corporations, and would-be ones. Such regulations include the Listing Rules of 2004, the Corporate Governance

¹²⁹ *Id.* at 225.

¹³⁰ George N. Sfeir, *The Saudi Approach to Law Reform*, 36 AM. J. COMP. L. 750 (1988).

¹³¹ It was issued by Royal Decree No. M/30, on July 31, 2003.

¹³² Article 4.A stipulates that “[a]n Authority to be named the ‘Capital Market Authority’ shall be established in the Kingdom and shall report directly to the President of the Council of Ministers. It shall have a corporate personality as well as financial and administrative independence. It shall be vested with all powers necessary to discharge its duties and functions under this Law. The Authority shall enjoy exemptions and facilities enjoyed by public corporations. Its staff shall be subject to the Labor Law.”

¹³³ Article 25.G.

Regulations of 2006, Prudential Rules, Merger and Acquisition Regulations, Market Conduct Regulations, Authorized Persons Regulations and the Corporate Governance of 2017.¹³⁴

In sum, with a deficient corporate law at that time, the Capital Market Authority played an essential role in supervising and monitoring not only the stock market but also the public corporations. The Capital Market Law empowers the Authority, with well-defined capacity, to build investors' confidence and preserve the integrity of the market's framework and institutions by all means.

4.The Companies Law of 2015 (CL)

Since the enthronement of King Salman (January 23rd, 2015), after the death of his predecessor, King Abdullah, the country has been experiencing far-reaching changes in its policies across the board.¹³⁵ One of the noteworthy changes was the passage of the most long-awaited piece of legislation, the Companies Law of 2015.¹³⁶ The Law has been enthusiastically welcomed by the

¹³⁴ For additional regulations and rules, see the Capital Market Authority's website, <https://cma.org.sa>.

¹³⁵ One of the significant changes the country has ever experienced, on political level, were the rewriting of the royal succession and the advancing of assertive foreign policy. See David Blair, *Saudi Arabia's Quiet Revolution as King Salman changes Royal Succession*, Tel.: World News (Apr. 29, 2015), <http://www.telegraph.co.uk/news/worldnews/middleeast/saudi-arabia/11571482/Saudi-Arabias-quiet-revolution-as-King-Salman-changes-royal-succession.html> (last visited Sep. 16, 2017), and Ben Hubbard, *Saudi King Rewrites Succession, Replacing Heir With Son*, 31, (June 21, 2017), N.Y. Times: Middle East, <https://www.nytimes.com/2017/06/21/world/middleeast/saudi-arabia-crown-prince-mohammed-bin-salman.html> (last visited Sep. 16, 2017).

¹³⁶ There is no exaggeration in describing this law as "the most long-awaited piece of legislation." Almajid in his book, which was his Ph.D. thesis, notes that "[a]ccording to the Minister of Commerce, Abdullah Yamani, the bill of the new Companies Law has been passed to the Prime Minister, King Abdullah, waiting for the issuance of the new law by a royal decree . . ." The Minister's press announcement was on January 24th, 2007. See Alsharq Alawsat Newspaper, ed. 10284, Jan 24, 2007, <http://archive.aawsat.com/details.asp?section=1&issueno=10284&article=403215#.WbwrXMBMyCQ>. More than 20 months later, Almajid questioned why the Law was not officially promulgated, and he expected to be announced within months. See Almajid, n. 632 at 180. Five years after the long waiting, the Law finally came into light and was promulgated by Royal Decree No. M/3 on November 9th, 2015, published in the Saudi Gazette (*Um Al-Qura*) on December 4th, 2015, and went into effect on May 2nd, 2016.

corporate public, including shareholders, stakeholders, directors, executive officers, and academics.

With an optimistic tone, the CL has been regarded as a revolution and one of the most significant laws the country has legislated recently. As one commentator states, the goals of the Law are to reinforce the developmental role of corporations to serve the national economy, to attract foreign capitals, to boost the role of the private sector, and ease the entry of Saudi entrepreneurs into the market.¹³⁷ Moreover, the CL is of paramount importance to carry out the Saudi 2030 Vision as it promotes the bases for an institutional work environment and ensures a high level of corporate governance practices in the Saudi corporate world, which will foster the transparency and the protection of shareholder's rights.¹³⁸

Speaking of form, the CL, in a nutshell, consists of twelve chapters embracing a total of 227 articles. The first chapter of the Law contains general rules applicable to all forms of enterprises recognized by the Law, such as the glossary. The other next five chapters are well-organized as each legally-recognized enterprise form is singled out in a separate chapter. The Law abandons three types of corporations that were recognized under the old Law, cooperative corporation, partnership limited by shares and variable capital company.¹³⁹ The canonical forms of enterprises in Saudi Arabia today are the partnership, limited partnership, unincorporated joint venture, joint-stock corporation, and limited liability company.

¹³⁷ FAISAL M. ALFADEL & SALEH A. ALBALWI, الوسيط في قانون الشركات السعودية: دراسة لنظام الشركات الجديد [THE ANATOMY OF THE SAUDI COMPANIES LAW: A STUDY OF THE NEW COMPANIES LAW OF 1437H AND THE PROFESSIONAL COMPANIES OF 1412H] 7-8 (L. & ECON LIBR. 2017) [hereinafter the Anatomy of Saudi CL].

¹³⁸ *Id.*

¹³⁹ There is no officially announced justification for why these three types were abolished, yet it may be logically attributed to the rare use of these corporate entity forms during the lifetime of the old Law. Cf. Francis Patalong, *New Saudi Arabia Companies Law: Effective 2016*, AL TIMIMI & CO. (Dec. 2016), <http://www.tamimi.com/en/magazine/law-update/section-14/december-january-3/new-saudi-arabia-companies-law-effective-2016.html> (last visited Sep. 16, 2017).

In terms of substance, the Law has many salient features, as opposed to the superseded one. One of the most significant features is the official recognition of the one-owner enterprise, in the form of single-shareholder joint-stock corporation and one-member limited liability company.¹⁴⁰ In the past, multiple one-person corporations were incorporated in exception to the Law, namely stated-owned corporations, where the government was the sole shareholder.¹⁴¹ Another feature is the clear-cut definition of the authorities controlling and supervising the enterprises.¹⁴² The role played by the Capital Market Authority following its foundation brought about sort of perplexity in terms of which controlled which.¹⁴³ The old Law assigned the regulating authority to the Department of Companies at the Ministry of Commerce and Investment, yet the Capital Market Authority was exerting power over listed joint-stock corporations without regulative frontiers. Now, the Law commissions the Ministry of Commerce and Investment with the regulatory authority over all types of enterprises, excluding listed joint-stock corporations, which is statutorily subject to the control and supervision of the Capital Market Authority.¹⁴⁴ The recognition of the holding company is also a remarkable feature of the Law. Even though there were a number of companies that claimed the holding status for their businesses, there were no rules or guiding principles to govern them.¹⁴⁵ In practice, if the enterprise wanted to operate as a holding one, it would be formed as a joint-stock corporation or limited liability company, and then the title

¹⁴⁰ See *infra* Chapter 3. Part I. E.

¹⁴¹ E.g., the Saudi Railways Company (SAR), <http://www.sar.com.sa/About-SAR/SAR-History.aspx>, and Saudi Arabian Oil Company (ARAMCO), <http://www.saudiaramco.com/en/home.html>. See also MOHAMMED H. ALJABER, القانون التجاري السعودي [THE SAUDI COMMERCIAL LAW], 179 (4.ed. 1996) [hereinafter Aljaber].

¹⁴² Article 1 defines the Competent Authority in charge of the Law as the Ministry of Commerce and Investment, and “ . . . as for joint-stock companies listed in the Capital Market, the Competent Authority shall be CMA.”

¹⁴³ See *supra* ch.2, I, A, 2&3.

¹⁴⁴ See *supra* n. 142.

¹⁴⁵ E.g., The Kingdom Holding Co.

“holding” would be added to its name without entailing any legal ramifications or being bound by any governing rules. However, the new Law singles out the seventh chapter for the regulatory framework for the holding corporations.¹⁴⁶ After all, the Law features an enhanced corporate governance framework that embraces global measures and principles alongside a range of sanctions, which are explored and analyzed later in the thesis.

It is worth bearing in mind that the fact that much ink has spilled over the distinct aspects of the Law (with optimism and enthusiasm) should not overlook the challenges and implications the Law may fetch. Its ink is barely dry. Since its issuance, the implementing regulations have not been announced yet. Amendments to the Foreign Investment Law in accordance with the new Law has not been addressed, which should be done in the very soon future, as the custom and practice take time to adapt. Also, subordinate regulations may be of necessity to provide details about the Law in a way that renders the Saudi corporate legal framework more responsive to broader global trends.¹⁴⁷

¹⁴⁶ The seventh chapter of the Law contains five articles. Article 182 defines the holding company as “a joint-stock or a limited liability company that aims at controlling other joint-stock or limited liability companies, called subsidiaries, by owning more than half of the capital of such companies or by controlling the formation of their boards of directors” Article 183 enumerates six legitimate purposes of holding companies, including managing its subsidiaries or participating in the management of other companies in which it owns shares and providing support thereto, investing its funds in shares and other securities, and owning real property and movable assets necessary for its operations. Article 184 emphasizes that “[a] subsidiary may not acquire shares in a holding company. Any action to transfer the ownership of shares from a holding company to a subsidiary shall be deemed null and void.” Article 185 require holding companies at the end of each year to prepare consolidated financial statements that include its subsidiaries, in accordance with recognized accounting standards. Article 186 mandates holding companies to abide by the provisions set forth in this chapter and other provisions of the Law not conflicting therewith, depending on the type of company adopted.

¹⁴⁷ Since the passage of the new Law, several articles and reports have done interesting comparisons between the two Laws. The authors of these comparisons have utilized a variety of novel formats, such as matrixes and graphs, to make the comparisons look alluring and easy to grasp. *E.g.*, Alain Sfeir & Nouf Aljoaid, *The New KSA Companies Law in Focus*, CLYDE & CO. LLP, CORP. News (Apr. 2016) (on file with the author), and

B. Supplementary Rules and Regulations

1. The Regulatory Rules and Procedures Relating to Unlisted Joint-Stock Corporations (RRPUC)

In acknowledgment of the special nature of close corporations, the Minister of Commerce and Investment, by the power vested in him,¹⁴⁸ announced by a ministerial resolution the Regulatory Rules and Procedures Relating to Unlisted Joint-stock Corporations (RRPUC).¹⁴⁹ In principle, these rules signify an unprecedented step forward for the world of close corporations in the region.¹⁵⁰

In a few words,¹⁵¹ this resolution includes eleven chapters and forty-eight articles covering a range of corporate matters that correspond to the unique structure of close corporations. Such matters are the remunerations of the board of directors, the use of technology to conduct general shareholder assembly, share buybacks, share sales, mortgaging of shares, issuance of preferred shares, share conversion, distribution of dividends, issuance and sales of preemption rights. Furthermore, the resolution includes official four appendixes, three of which are concerning mortgaging of stocks, and the fourth is an authorization form.¹⁵²

Given that most Saudi business establishments are non-listed encourages the Competent Authority to appreciate these businesses and acknowledge their pressing, structural issues in their corporate governance. The inconsistency of the corporate governance framework with the social and economic basis of close corporations gives rise to deficiencies and may not realize the goals

¹⁴⁸ It is prescribed in Article 225 that “ . . . 2- the Minister and CMA’s Board shall, each within their jurisdiction, issue necessary decisions for the implementation of the provisions of the Law.”

¹⁴⁹ See *supra* Ch.1, IV, A (<https://www.uqn.gov.sa/articles/1480082743260579300/>).

¹⁵⁰ This Ministerial Resolution is written in Arabic and has not been officially translated into other languages, namely English. Therefore, the author strives to translate these rules in a way that closely mirrors the exact meanings in Arabic context.

¹⁵¹ An extensive reading and analysis of these rules are situated in the fourth chapter later in this thesis.

¹⁵² See *supra* n. 150.

of the corporate governance, such as the reduction of agency problems and transaction expenses.¹⁵³ This calls for effective legal governance mechanisms that offer protection for shareholders from the misconduct of others.¹⁵⁴ Whether these rules afford an adequate degree of protection for minority shareholders against the misconduct of controlling shareholder or the opportunism of the board of directors is of the research questions. The research answers it through an in-depth analysis of these rules and the rules of the Companies Law to come up with a good understanding of what would optimize the Saudi legal framework of corporate governance for close corporations.¹⁵⁵

2. The Guide of Corporate Governance of Family Companies and its Directive Charter

The influence of a family over its business in the form of non-listed corporations oftentimes generates conflicts and tensions among members of the family and its generations or between minority shareholders and controlling ones (in the long run), which weakens the business or sometimes leads to bankruptcy or dissolution of the corporation. Therefore, it is highly recommended that family companies adopt a charter or guidelines that adopts special corporate governance rules tailored to suit the needs of the family business. Unlike the “thorny governance” faced by family corporations,¹⁵⁶ family businesses with straightforward corporate governance rules tend to maintain the sustainability of their corporations, realize their ends, and stay competitive and efficacious.¹⁵⁷

¹⁵³ See JOSEPH A. McCAHERY & ERIK P. M. VERMEULEN, CORPORATE GOVERNANCE OF NON-LISTED COMPANIES 2,3 (Oxford Univ. Press 2009) [hereinafter McChathery, Corporate Governance of Non-Listed Companies].

¹⁵⁴ *Id.*

¹⁵⁵ See *supra* note 151.

¹⁵⁶ McChathery, Corporate Governance of Non-Listed Companies, at 4, (criticizing the informal governance of family-owned corporations as it is the main cause these corporations fail to resist “the dynamic changes in both the family and business cycle.” Such changes are entry of new generation and alteration in the business’s strategy, which renders the business prone to failure).

¹⁵⁷ *Id.* (arguing that legislators bear the burden to make family businesses implement a good level of corporate governance that leads to the success and continuity of the business, and stating an example of empirical study that concludes poor governance has led to large declines and significant long-term

In an effort to raise the awareness of family-business owners, the Minister of Commerce and Investment announced (July 2014) “the Guide of Corporate Governance of Family Companies and its Directive Charter.” The Guide consists of seven chapters with forty articles. It establishes the primary foundations for institutional entities and necessitates the significance of adopting corporate governance, and the separation of management and ownership. In addition, it calls for the adoption of the efficiency and competency standards in electing the management team along with finding a precise mechanism for a dispute resolution that protects the business’s reputation. This guide also advances selective rules and principles that the family charter should contain, and it draws the systematic framework for family businesses to promote transparency and achieve a high level of sustainability and stability.¹⁵⁸

As it may be obvious, this ministerial endeavor was before the passage of the CL of 2015. That reflects on the Competent Authority’s awareness of the fact that the one-size-fits-all corporate law and governance may lead to unwanted results.¹⁵⁹ Also, it may not promote the efficiency and improve the sustainability and transparency for close corporations—as corporate governance is supposed to produce. Nonetheless, the guidelines arguably suffer from a structural defect that they are noncompulsory. The family-business owners have the absolute discretion to opt for these rules. The good news is that several sophisticated family-owned businesses realized the importance of adopting these rules and voluntarily turned them into an inseparable part of their articles of

underperformance. Another advantage of strong corporate governance –besides the fact that it promotes effective tools to deal with and settle familial conflicts- is the correlation between effective corporate governance of family businesses and the growth in innovations they create because the priority given to long-term development over short-term profitability). *E.g.*, Gonzalez & Daniel Wolfenzon, *Inside the Family Firm: The Role of Families in Succession Decision and Performance*, 122 Q. J. ECON. 647 (2007).

¹⁵⁸ These guidelines are in Arabic and have not been officially translated into other languages, namely English.

¹⁵⁹ McChathery, *Corporate Governance of Non-Listed Companies*, at 3, (claiming that one-size-fits-all model does not benefit close corporations due to the disproportionate application of the corporate governance principles. Plus, this model results in high compliance costs borne by close corporations).

incorporations, after knowing the economic gain and social benefits the adoption of these guidelines generate.¹⁶⁰

3. Templates for the Articles of Incorporation and Articles of Associations

In compliance with the Law,¹⁶¹ the Minister of Commerce and Investment issued templates for the articles of incorporation—for each sort of enterprise the Law comprehends. These templates aim at easing the incorporation of enterprises (as they include the requirements of the Law) as well as certify the CL implementation. It was the first implementation of the Law as Article 225 instructs the Minister of Commerce and Investment to release these guiding forms within 120 days from the issuance date of the Law.¹⁶² As far as close corporations concern, they have two templates representing the constitutional documents of any joint-stock corporation: a template for the articles of incorporation¹⁶³ and a template for the articles of association (the establishing contract).¹⁶⁴ These embody comprehensive documents for every detail and element of the corporation. In addition, they seem to be self-explanatory; however, this does not negate the importance that these documents should be filled out by specialists (e.g., lawyers) who can understand the ramifications each element produces and inform the owners of the business about them. Another recommendation is that these templates should be officially translated into other languages (e.g., English and Chinese) to facilitate the entry of foreign investors.

¹⁶⁰ E.g., AlZamil Group Holding Company.

¹⁶¹ Article 225 reads that “1- [g]uiding forms for the articles of incorporation and articles of association for each type of company shall be issued pursuant to a decision by the Minister within 120 days from the issuance date of the Law, and shall be published on the Ministry’s website. Such forms shall be valid from the effective date of the Law.”

¹⁶² See *supra* Ch.2, I, A, 4.

¹⁶³ See template No.3, the Ministry of Commerce and Investment, <https://mci.gov.sa/cl2015/Documents/05.pdf>, (last visited: Sep. 18, 2017).

¹⁶⁴ See template No. 4, The Ministry of Commerce and Investment, <https://mci.gov.sa/cl2015/Documents/06.pdf>, (last visited: Sep. 18, 2017).

4. The Corporate Governance Regulation of Unlisted Corporations (CGUC)

In the fifth of October 2018, the official gazette published the Corporate Governance Regulations of Unlisted Corporations,¹⁶⁵ mirroring the steadfast commitment of the Ministry of Commerce and Investment to the continuous improvement of the Saudi market. The Regulation consists of a set of rules and principles that ensure the best practices of corporate governance. Unlike the Corporate Governance Regulations of listed Corporation, the observance of this Regulation by close corporations is voluntary. At the onset, Article two makes it crystal-clear that unless it is obligated by the Companies Law or another legal instrument (e.g., resolution, law or regulation), the Regulation is mere, non-binding guidance that aims at formulating an effective, legal framework for the governance of the corporation.

The Regulation underscores the importance of an effective framework of corporate governance as it reinforces shareholder rights and fosters his role in overseeing the corporation. Furthermore, effective corporate governance ensures transparency, integrity, and fairness of corporate transactions as well as it offers effective tools to handle related-party transactions. It also provides a healthy environment where corporate officers are held accountable for their actions. The Regulations comes to transform these broad goals into applicable rules the corporation may adopt to form its governing structure.

As a critical observer of the regulatory framework of close corporations, it appears to be justifiable not to compel all close corporations to follow the CGUC for two reasons. First, close corporations vary in their sizes and the number of their shareholders. Therefore, from a cost-benefit analysis, it may be unwise to subject all corporations to unnecessary rules and other aspects of governance as they may be costly and may render few or no direct benefits to the corporation. The

¹⁶⁵ See Um Al-Qura Gazette, <https://www.uqn.gov.sa/articles/1538687463811469400/> .

adoption of best corporate governance practices should be decided by the corporation itself based on a wide range of variables, including the size of the business and the sophistication of its shareholders. A corporation with the statutory minimum of share capital and shareholders may realize no benefits from complying with the CGUC but uncalled-for costs.

Second, as it is exposed later in this research, the Companies Law has already regulated the governance of close corporations by a host of obligatory rules that, from a comparative point of view, constitute unprecedented intervention by the legislative body in regulating corporations and their governance structure. Therefore, mandating more governing rules—and thus shrinking the contractual freedom of shareholders— would be counterproductive as it overregulates the corporation and thus makes it a less attractive form of business.

Part II. The Ownership Structure of Joint-Stock Corporations in the Saudi Market

Overview

Most of the comparative and empirical studies of corporate governance establish a solid connection between the system of corporate governance the country adopts, and the structure of ownership dominating its corporations. It is regarded as one of the essential elements in shaping the country's pattern of corporate governance, bearing in mind the differences among corporate governance systems.¹⁶⁶

¹⁶⁶ *E.g.*, the German corporate governance requires a representation of the labor in its corporation, while such a requirement does not exist neither in the United States nor the United Kingdom.

To elucidate, public corporations in common law countries (e.g., the United States) enjoy dispersed ownership structure,¹⁶⁷ which involves a corporate governance system that addresses the agency problem between managers and shareholders.¹⁶⁸ On the other hand, in Civil law countries—and arguably developing countries— concentrated ownership is the prevailing structure of corporations, and hence a different system of corporate governance is undoubtedly required to handle the agency problem between majority shareholder and minority ones this time.¹⁶⁹

In Saudi Arabia, it is argued that concentrated ownership structure prevails in its corporate arena.¹⁷⁰ Studies attribute the phenomena (the concentrated ownership structure) to a couple of reasons.¹⁷¹ First, the legally driven reason. The fact that the Saudi Companies Law of 1965 was vastly affected by the French Companies Code makes it fair to characterize the country as a civil law country, so a concentrated ownership pattern is expected to dominate.¹⁷² Another reason that justifies the domination of concentrated-ownership structure is a politically driven one. It is contended that countries with monarchies or a lack of democratic systems tend to have highly concentrated ownership structure, and thus a fragile protection system for minority shareholders, resulting in substantial shareholdings in the hand of few moneyed families together with the

¹⁶⁷ In fact, 94% of listed corporations in the United States do not have a single shareholder with more than 25% ownership of their capitals. See S&P Global Market Intelligence, <https://marketintelligence.spglobal.com>.

¹⁶⁸ Which is also known as the first agency problem that involves conflicts between the owners of the corporation (principals) and its managers (agents). The problem resulting out of such a relationship is how to ensure that managers advance the interests of the corporation's shareholders and put them ahead of theirs. See REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 29, 30 (Oxford Univ. Press 3rd. ed. 2017)

¹⁶⁹ See *supra* n. 56, 57.

¹⁷⁰ See Almajid, at 207–211.

¹⁷¹ One of the most cited studies that undertakes the analysis of ownership structure is the study conducted by La Porta and his colleagues. According to their “laws matter” theory, legal institutions widely influence the structure of ownership in corporations. See Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471,474 (1999).

¹⁷² *Id.*

government.¹⁷³ For an observer of the Saudi market, it is evident that both reasons are valid to explain the presence of concentrated ownership structure in the market.

Another explanation that has debated the validity of the former reasons (legally driven and politically driven) to substantiate the divergence of the ownership structure and thus the existence of various corporate governance schemes is a financially motivated reason. Advocates of this thought suggest that the development of financial markets better expounds differences in corporate governance systems.¹⁷⁴ Financial markets with a strong presence of all internal institutions and easy access to capital tend to have diffused ownership structure, whereas underdeveloped financial markets with difficult, if not impossible, and prohibitive access to the capital tend to subsist concentrated ownership patterns because of the lack of public participation in the market.¹⁷⁵ Such a reason may be logical and tenable to explain the concentration of ownership in Saudi public corporations, knowing the slow growth of the Saudi market.¹⁷⁶

As far as close corporations are concerned, it may be misapprehended that there is not much to say about the ownership structure of close corporations since these enjoy an omnipresent

¹⁷³ See PETER A. GOUREVITCH & JAMES SHINN, POLITICAL POWER AND CORPORATE CONTROL: THE NEW GLOBAL POLITICS OF CORPORATE GOVERNANCE 80,81 (Princeton Univ. Press 2005); Almajid, at 208, (adding also the political transparency side by side with firm-level one because of the confidence and trust it brings about for investors).

¹⁷⁴ One of these advocates is John Coffee, who contends that neither the politically driven reason nor the legally driven one suffices to explain the divergence in corporate governance systems and corporate ownership structure. See John C. Jr. Coffee, *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1, 82 (2001).

¹⁷⁵ See Maren Hanson, *The Influence of French Law on the Legal Development of Saudi Arabia*, 2 ARAB L.Q. 272, 291 (1987) (claiming that concentrated ownership exists not only in Saudi Arabia but also other developing countries due to the role played by the governments in managing and supervising business behaviors).

¹⁷⁶ See Almajid, at 209 (asserting the plausibility of such reason given the history of Saudi market development. Since the establishment of Saudi market in 1948, the Saudi market stayed underdeveloped until the introduction of technology in stock-trading in the 1990s. Plus, the public, namely small investors, refrained from trading in the market because of the high cost of share trading at that time. In addition, the Saudi market suffered from unpopularity at that time because the scarcity of initial public offerings aimed at the public).

ownership structure where there are a few shareholders who are quite often family members and friends. Nevertheless, it is of importance to zoom out for a bit and examine the ownership structure of the joint-stock corporations, listed and unlisted. This helps to accurately evaluate the corporate governance principles and its development in the region.

A. Public Corporations

1. State-Controlled Corporations

The existence of the Saudi government in the Saudi market is of a unique nature. Through three major governmental agencies, the Saudi government exerts a great deal of clout over the Saudi public corporations.¹⁷⁷ Governmental investments in listed corporations come through the considerable ownership held by its agencies: The Public Investment Fund, the Public Pension Fund, and the General Organization for Social Insurance, alongside its direct ownership in some major corporations in the market.¹⁷⁸ Given that the value of Saudi stock market is about 1739.3 billion riyals,¹⁷⁹ while the value of government shareholdings is collectively 706 billion riyals

¹⁷⁷ Almajid, at 212, (considering that the Saudi government's involvement in stock-trading has always remained paramount since the establishment of the market).

¹⁷⁸ However, the government has lately transferred many of its direct shareholdings to the Public Investment Fund, making the Fund alongside the other two agencies the sole investment vehicles by which the Saudi government participates in the market. *E.g.*, the Saudi Electricity Company announced that the three billion government-owned shares representing circa 74% of the total capital of the company were registered for and transferred to the portfolio of the Public Investment Fund. *See* Alarabiya.net, *Three Billion Shares: The Government's Stake in Saudi Arabia Electricity* (Sep. 17, 2017) ALARABIYA.NET, Arabian Markets, <https://www.alarabiya.net/ar/aswaq/companies/2017/09/17/-3-تسجيل-مليارات-سهما-حكومية-بالسعودية-للكهرباء.html>, (last visited Sep. 22, 2017).

¹⁷⁹ As of September 17, 2107, Argaam reported an increase of the market value of shares and enclosed to the report a detailed table with the shareholdings' percentages and values of all types of investors, including government agencies and foreign investors. *See* Argaam, *Saudi Market: The Market Value of Shares Slightly Higher to 1739.3 Billion [Saudi] Riyals by the End of Las Week and Ownership of Foreign Investors Constitute 4.62% of them* (Sep. 17, 2017), Argaam, Special, <http://www.argaam.com/ar/article/articledetail/id/505129>, (last visited: Sep. 22, 2017).

(161.84 billion U.S. dollar),¹⁸⁰ it becomes unmistakable that the government is the largest shareholder with ownership of circa 40%.¹⁸¹

To perceive the controlling role of the largest shareholder, contemplate that all CEOs and boards' members of listed corporations the government invests in are appointed, hired and fired by the government. This shows the financial and directorial influences of the government over listed corporations, which leaves no room for other shareholders, irrespective to the size of their shareholdings, to have a say or active role in the management of a corporation the government dominates its ownership.¹⁸²

In a brief assessment of this ownership structure, a set of benefits have flown from this structure into the region. For example, corporations with substantial government shareholdings tend to be better managed, financed, and more lucrative than other listed corporations.¹⁸³ Shareholders show a tendency to invest more in corporations with an influential state standing, rather than other corporations with no such thing. Another advantage is that government-controlled corporations¹⁸⁴ showed earlier strong signs and genuine intention to adopt the best practices of corporate

¹⁸⁰ *Id.*

¹⁸¹ This percentage represents the market value of the shareholdings of government agencies alone, so it must be higher than 40% if the government investments in other funds are counted, such as the Central Bank of the Kingdom. *See* Almajid, n.731.

¹⁸² *See* Almajid, at 213 (adding another layer of complexity as members of the board elected by other party than the government may not challenge the government representatives' managerial decisions, specially decisions involved major consequences for the corporation. Therefore, "politics [Alamjid thinks] interact with economics in a way which seems to let the former impose its wishes on the latter.")

¹⁸³ This may stem from the fact that these corporations enjoy a noncompetitive market in terms of the services and the nature of their business activities, such as utilities service corporations and corporations in the petrochemical industry. *See* Almajid, at 214.

¹⁸⁴ Such corporations were Saudi Arabia Basic Industries Corporation (the world largest petrochemicals manufacturers) and Saudi Telecom Company (STC). It is worth noting that the 70% of SABIC's shares are government-owned, and the remaining of 30% are publicly traded on the Saudi market. *See* SABIC's website, <https://www.sabic.com/en/about>, (last visited: Sep. 22, 2107).

governance, which made them positive models of efficiency other corporations began to copy.¹⁸⁵ Another benefit derived from such structure is that investments in state-controlled corporations are of the lowest risk investments because of the protective role played by the government. Such a benefit leads to shareholders feeling safe, more reassured when they invest in these corporations, and fearless of these corporations going bankrupt.¹⁸⁶

As this ownership structure has yielded some benefits in the region, it nevertheless suffers several disadvantages. The major downsides of the structure are the lack of liquidity and diversity in the market. The government seems to play a passive role in terms of trading volumes. Indeed, it tends to hold its shareholdings to preserve a long-established position, which has resulted in insignificant numbers of stocks available for the public and thus has made the market illiquid. The illiquid market finds it challenging to entice investors, especially foreign ones, which makes the market less diverse and limited to certain players: government agencies, institutional investors and affluent families.¹⁸⁷

2. Family-Controlled Corporations

One of the main traits of developing markets is considerable familial ownership of its corporations. Oftentimes government ownership and family ownership are in parallel, so are they in Saudi Arabia.¹⁸⁸ Family-controlled corporations undeniably are of the leading actors in the

¹⁸⁵ One of these corporation was Savola, a family-controlled corporation. Savola had a head start in setting up its corporate governance code. *See* Almajid, n. 736, (talking in detail about the Savola's corporate governance experience).

¹⁸⁶ *Id.* at 214.

¹⁸⁷ *Id.* at 216, (arguing that active trading by governmental agencies may result in massive price swings because of the illiquidity of the market and its incapability to ingest a voluminous bowl of shares). Also, this serves as evidence for the financially driven reason for the concentration of ownership in the Kingdom.

¹⁸⁸ *See* Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471,474 (1999) (stating that family ownership dominates developing countries and those whose laws flow from the Civil law system, so rich families are eager to hold large shareholdings in the listed corporations on the market).

corporate arena in the region,¹⁸⁹ given the economic role of these corporations and their substantial contributions into the national gross domestic product (GDP).¹⁹⁰

The foremost aspect of these corporations is that their shares are traded on the market exchange, while they were originated as family businesses in the form of sole proprietorship until close corporation, whose owners continue to manage the business and exert control thereupon even after the business's going public.¹⁹¹ Surely, such an option (conducting initial public offering) depends exceedingly upon several factors, and not practically available to all close corporations.¹⁹² Such factors are the size of the corporation, its readiness to go public and the sophistication of its departments to the financial market. These listed corporations ordinarily bear titles of the families owning controlling shareholdings in the corporations.¹⁹³ The controlling shareholdings of

¹⁸⁹ These corporations operate across all sectors, such as cement, transport, agricultural, petrochemicals and so on.

¹⁹⁰ See *supra* ch.2, I, B, 2. (referring to the guide of corporate governance of family businesses).

¹⁹¹ Almajid, 217, (asserting that positions of wealthy families are further heightened due to their bonds with members of the royal family). See also Michael Field, *The Merchants: The Big Business Families of Saudi Arabia and the Gulf States*, Woodstock, N.Y.: Overlook Press, (1985).

¹⁹² A noteworthy advance—as part of the ongoing development of the Saudi stock market and in an effort to accomplish the goals of 2030Vision—is the introduction of Souk Nomu in late February 2017. This is a parallel share market that serves an alternative platform for small-sized and medium-sized corporations with the intention to go public. This option affords less stringent listing rules, yet trading on this market is restricted to qualified investors. It is an optimal option for close corporations that are not ready yet to conduct IPO but desire to finance their businesses through the sales of shares, so Souk Nomu represent a preparatory stage for these corporations to make them ready to be listed on the main market. To learn more about Souk Nomu, see generally Tadawul, *Nomu - Parallel Market* (2017) Tadawul, Knowledge Center, <https://www.tadawul.com.sa/wps/portal/tadawul/knowledge-center/about/parallel-market>, (last visited: Sep. 26, 2017).

¹⁹³ E.g., AlDrees, AlOthaim, AlZamil, AlRajhi, AlHokair and AlTair corporations. The family's ownership in each of them exceeds 40% of total capital. For details about capital allocations, see Tadawul website, https://www.tadawul.com.sa/wps/portal/tadawul/home!/ut/p/z1/04_Sj9CPykssy0xPLMnMz0vMAfljo8zjYycLQwtTQx83D39zA0cAx09wtzCQowNDEz1w_Wj9KPwKTGBKjDAARwN9AuyswMBEuKIug!!/d/z/d5/L0lDUmlTUSEhL3dHa0FKRnNBLzROV3FpQSEhL2Vu/.

corporations held by Saudi families may also result from the direct possession of the corporation's shares through the market by a single family.¹⁹⁴

The extreme concentration of corporate ownership in the hand of few families has resulted in immense fortunes for the latter. In addition, members of the families enjoy a great deal of latitude over the corporation as they occupy high-ranking positions and senior offices (e.g., corporate officers and managers). This may produce some concerns and raise questions about the integrity of their decisions and whether they advance their interests, rather than the interests of the corporations and all its shareholders as owners of the business.¹⁹⁵

3. Publicly-Owned Corporations

The last category of listed corporations are the ones with fragmented ownership structure, where neither the government (through its agencies and funds) nor well-heeled families hold a controlling proportion of the corporation's capital.¹⁹⁶ This type of corporations includes small-sized and medium-sized businesses and has a little impact on the stock market.¹⁹⁷

The emergence of this sort of corporations and thus the entry of the public into the market are attributed to the creation of the Capital Market Authority and its following efforts to build the trust and confidence in the market.¹⁹⁸ Its creation was a milestone in the history of stock-trading in Saudi Arabia as it was put in charge of regulating and supervising the market. In exercise of its

¹⁹⁴ Almajid, at 217, (giving examples of AlZamil family [owning circa 10% of stocks in 4 huge corporations] and AlRajhi family [possessing around 20% of share capital of three quoted corporations]).

¹⁹⁵ In principle, capital markets of both developed countries (e.g., Japan, Hong Kong and South Korea) and developing countries (e.g., markets of GCC countries) are alike in terms of the ownership pattern though there may vary slightly in the level of concentration. See Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471,474 (1999).

¹⁹⁶ E.g., the IPO of Alinma Bank is a good example of such corporation, when the government offered around 70% of its common shares to the public on an equal basis, which widened the base for investors. See Almajid, 221.

¹⁹⁷ *Id.*

¹⁹⁸ The number of IPOs following the establishment of the Capital Market Authority is an obvious sign of the active role played by the Competent Authority.

power, the Authority, since its establishment, has thrived in facilitating the market and making it more appealing, not only for local investors but also for foreign ones.¹⁹⁹ Furthermore, the lack of investments channels in the region left the Saudi people with no choice but to invest in the market, specifically from 2004 to 2005,²⁰⁰ when the market was a feasible source of income.²⁰¹ Moreover, since the oil has always been the rationale behind any economic growth in the region and in an effort to diversify the national incomes, the government has taken several steps to spur individuals to invest in the market as part of economic development.²⁰²

C. Close Corporations

1. Stated-Owned Corporations

Corporations are of the foremost inventions of modern history as vehicles to carry out business, industrial, and infrastructural purposes by not only individuals but also governments. The Saudi government has incorporated a large number of corporations to embark upon a variety of activities across the board.²⁰³ For instance, the Saudi Railways Company, and the Saudi Arabian Military

¹⁹⁹ All fundamental changes by the Capital Market Authority have succeeded in bringing about development and investments into the market. Such Changes was the issuance of listing rules and the flow of IPOs afterwards. As evidence, see *supra* note 179 (reporting an increase in the ownership of foreign investors to circa 5%).

²⁰⁰ See Almajid, at 219 (during that time, the share index recorded a dramatic jump of 120% of annual growth).

²⁰¹ In comparison, people of other countries (e.g., the United Arab Emirates) with similar condition and economic resources to Saudi Arabia's had better investment opportunities and alternatives to select therefrom. However, Saudis did not. Therefore, some argue that the investment compass of Saudis signaled to the stock market as a response to the several social and economic changes following the increase of oil prices and in repatriation of Saudi capitals overseas following September 11 attacks. See Almajid, at 219 (explaining that the Saudi government immobilism led to the failure to accommodate Saudi entrepreneurs in the market that suffered shortage of investment opportunities).

²⁰² Another reason worth bearing in mind is that investors themselves have the right to freely trade on the market., unlike other jurisdictions where trading is confined to licensed investors (brokers and intermediaries). See *also* Almajid, at 220 (finding the ability of investors to trade themselves on the market a major factor for the massive volume of share-trading on the Saudi market in terms of the transactions by individuals, as opposed to those executed by mutual funds and other financial institutions).

²⁰³ In fact, all state-controlled corporations (e.g., STC and SABIC) were offered to the public and listed on the market and that all backdated the Vision. However, the Vision makes it clear that it is of its mission to

Industries Company.²⁰⁴ Most importantly, state-owned corporations undertake huge projects that require massive capitals and preexistent infrastructure (e.g., public transportations and airlines), or projects with high level of sensitivity (e.g., military industries, oil extraction, and petrochemicals), which makes the state-owned corporations oftentimes are the leading corporations across all sectors. Private investors may be reluctant to conduct the former category of businesses because of the less lucrative appearance of these businesses, at least on the short term, or may not obtain the license to conduct the latter.

Prior to 2015, such corporations would have to be incorporated by a royal decree since they were established in exception to the Companies Law of 1956,²⁰⁵ and such an exception had to be obtained from the top of the regulatory pyramid, the King. The Law of 2015 rectified the situation and filled the gap in the regulatory framework of the corporation as it officially recognizes the incorporation of one-person enterprises (joint-stock corporation and Limited Liability Company), and they are incorporated—like other forms of enterprises— by a ministerial resolution.²⁰⁶

Nowadays, most of the state-owned corporations have been offered to the public, and their shares are traded on the Saudi stock exchange—even though the government still owns an overwhelming majority of these corporations' shares²⁰⁷— as part of the 2030 Vision to privatize

privatize government services. *See* 2030 Vision website, <http://vision2030.gov.sa/en/node/6>, (last visited: Sep. 26, 2017).

²⁰⁴ This company was incorporated in pursuit of one of the commitments by the 2030 Vision that aims at localizing defense industries and repatriate more than 50% of military equipment expenses by 2030. *See generally* 2030 Vision website, <http://vision2030.gov.sa/en/node/6>, (last visited: Sep. 26, 2017).

²⁰⁵ The 1965 Companies Law required in Article 52 a royal decree be issued in approval for incorporation of five kinds of joint corporations: concessionaire corporations, corporations managing a public utility, corporations receiving governmental subsidy, corporations with the government or a public legal entity as shareholder, corporations with banking activities.

²⁰⁶ *See infra* Chapter 3. Part I. E.

²⁰⁷ *Supra* ch.2. II. A.

all state-owned corporations. Nevertheless, the privatization and listing of state-owned corporations took place several times before the announcement of the 2030 Vision.²⁰⁸

This forward movement toward privatizing of government-owned corporations and offering their shares to the public is expected to contribute around 65% of the general domestic production, instead of 40%.²⁰⁹ Furthermore, it will improve the quality of services and products these corporations make, given the entry of new investors into the market and the creation of a competitive environment.

2. Family-Owned Corporations

Family-owned corporations are the dominant, widespread pattern of ownership in the corporate arena in almost every country. These corporations are usually the natural development of the sole proprietorships; the growth and expansion of a business over time necessitate the transformation of the business into a joint-stock corporation or LLC.

The nature of management of these businesses varies in its levels of sophistication. In general, most of these corporations are founded out of a purely helpful act by owners of a single family, or sometimes by owners with personal relationships in common (e.g., friends). Nevertheless, a growing number of family-owned corporations have realized the inherent issues associated with family-held corporations in terms of the sustainability of the business and its continuity to the next generations. Therefore, to tackle such issues at an early phase, these corporations have voluntarily adopted a wide range of corporate governance principles in running their businesses with the goal of sustaining their existence, captivating other investors and often taking them public.²¹⁰

²⁰⁸ *Supra* ch.2. II. A.

²⁰⁹ See 2030 Vision website, <http://vision2030.gov.sa/en/node/6>, (last visited: Nov. 08, 2017).

²¹⁰ It is true that shareholdings of family businesses are normally circulated within the family may not be transferred to outsiders unless proven by other shareholders. However, the investors may be in the form of another acquirer corporation or franchisor, given adoption of corporate governance principles in the

Furthermore, the importance of regulating Saudi family businesses stems from the fact that Saudi family businesses constitute circa 90% of the operating establishments in the Saudi market with an estimated capital investment of 250 billion Saudi Riyals (roughly \$67 billion).²¹¹ Most of these entities are LLCs and close corporations.²¹² Bearing these numbers in mind, one may imagine the leading force of family establishments in the region in various sectors of the national economy.²¹³ The Saudi family businesses, as the heartbeat of the private sector, are the major employers in the Saudi labor market. Family businesses provide eighty percent of the total employment in the private sector.²¹⁴

management of the corporation makes the corporation more attractive to investors and an appealing target for massive capital.

²¹¹ For the sake of academic integrity, these figures have been circulated around for a while and cited in various journal reports and some papers. However, the author is deeply skeptical about the accuracy of these numbers and to which extent they reflect the reality of corporations' contributions due to the scarcity of statistical or survey data can be relied upon, after examining the methods and variables utilized resulting in these numbers and making sure there is no selective bias may adversely affect the results. In addition, these numbers are claimed to represent the contribution of family businesses without distinguishing between the forms of enterprise (joint-stock corporation or limited liability company) these families adopt to carry out their businesses. Furthermore, these figures represent the contributions made by all family enterprises, listed and non-listed, which not correspond with the notion that close corporations differ from public ones and thus they should be regulated differently. Intuitively, they are the majority; however, an official figure is of necessity to better evaluate their positions, laws and regulations, instead of seemingly arbitrary numbers. For this research, all figures are assumed true and reliable unless proven otherwise.

²¹² A recent trend in family ownership structure in their business is to incorporate a holding company and transfer their ownership in the operating business into stocks in the holding company, which becomes the sole shareholder of the operating business (the subsidiary).

²¹³ To elaborate, approximately 90% of the operating establishments and businesses in Saudi market are conducted by families. Family-controlled firms collectively contribute 50% of non-oil gross domestic product. Beyond the scope of the Saudi market, Saudi family businesses represent 48% of all family businesses in the Middle East. *See* the National Center for Family Business, <http://www.events.csc.org.sa/Arabic/FamilyBusinessesNationalForum/Pages/Event-Sponsors.aspx>, (last visited: Sep. 18, 2017).

²¹⁴ *See* McChathery, *Corporate Governance of Non-Listed Companies*, at 4, (emphasizing the importance of family-owned businesses as they promote economic prosperity, on the one hand, and enhance the social welfare on the other hand as they are viewed as job-creating corporations,); Belen Villalonga & Raphael Amit, *How Do Family Ownership, Control and Management Affect Firm Value?* 80 J. FIN. ECON. 385 (2006).

All in all, the importance of corporate governance for family corporations escalates because of their vital roles in the Saudi national economy and the creation of jobs in the region. Therefore, the CL of 2015 sets forth rules that enhance the corporations' performance and help them become institutional entities.

3. Start-Up Corporations

In addition to the traditional form of close corporations (family-owned and small-scale), startups and high-tech corporations constitute a vital subset of close-corporation form as they have several traits in common, such as few participants, no public market and overlap between capital and labor suppliers.²¹⁵ Startups and venture-capital-backed businesses may be incorporated in the form of a joint-stock corporation. Despite the significance of this sort of enterprises as highlighted above and being a main target of the new Law, no official record has been established yet concerning the number of these corporations. Nevertheless, this research assumes the protection of minority shareholders in these corporations as well, whether the position of minority shareholder is occupied by an entrepreneur or investor (e.g., venture capitalists). Given the formalities of the joint-stock corporation form, one may wonder—yet such a wonder falls beyond the scope of this research—whether a startup business should be incorporated in the form of a joint-stock corporation or limited liability company in terms of which form could offer the best efficiency, flexibility and ability to meet the business's needs.²¹⁶

²¹⁵ See Edward B. Rock; Michael L. Wachter, *Waiting for the Omelet to Set: Match-Specific Assets and Minority Oppression in Close Corporations*, 24 J. CORP. L. 913, 916 (1999) (concluding that close corporation forms are best to answer the needs of businesses with “a high density of match-specific assets because this form with its cardinal principle of no pro rata distributions will guarantee the maximizing of minority's interests as majority the majority maximizes its, preventing any opportunistic behaviors).

²¹⁶ *Id.*

Conclusion

Historically, even before the unification of the Kingdom, corporations have received the attention of the Saudi legislature through various laws and regulations. It began with only seven articles of the commercial code, whereas nowadays several laws and a wide range of regulations and circulars regulate the corporate world, alongside multiple authorities dedicated to serve and supervise this world. Nevertheless, the development of the regulatory framework of corporations did not correspond to the rapid growth of the economy and the evolution of corporations. Two significant events throughout the history of corporations are regarded as the cornerstones of corporate development. The passage of the Capital Market Law and the foundation of its authority mark a watershed in the history of not only the stock market but also public corporations. The flow of IPOs and the broad entry made by local investors (following the passage of the law and the establishment of the competent authority) betoken the significance of that phase of corporate-stock history. It was the first-ever introduction of corporate governance concept into the region. The other landmark in the history of the Saudi corporate world is the birth of the Companies Law of 2015 amid an ocean of sweeping reforms, economically, socially and politically. Many hopes and predictable changes have been pinned on the Law; however, it may be early to assess the outcomes of the Law and its success in attaining its ends.

Knowing the undisputable prominence of the corporate governance rules in the success of the corporation and the effect of the concentrated ownership structure on the shape these rules have led to adopting a couple of corporate governance settings. The dynamic presence of the government (the largest shareholder) in the stock market along with the dominance of wealthy family over their listed corporations require a different set of corporate governance rules from the ones that suit close corporations. They may, however, share the same agency problem where the

principal is the minority shareholder and the controlling shareholder is the agent, yet the expectations of the principals are contrasting, and so are the protective rules for minority shareholders. All in all, the passage of the CL ushers in a new era for the corporations in the region with the goal of generating an attractive environment for both local and foreign investors. Such a goal requires the strong presence of corporate governance rules that, *inter alia*, protect the rights of the minority shareholders and the newcomers to the market.

Chapter Three: Joint-Stock Corporations in the Law[†]

“A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law.”

John Marshall

Motivating Hypothetical

Saad thinks about accepting his father offer to join him in the corporation. However, he does not have the know-how to incorporate the corporation. Furthermore, Saad is also interested in serving on the board of directors; however, he is unsure whether his shareholding lands him in the boardroom. If so, he would like to know his responsibilities and duties as a director; otherwise, Saad wants to know whether he has a voice over the corporate matters if any. In addition, his father desires to be both the CEO of the corporation and the chairperson of the board, so Saad is wondering about the legality of this desire, and whether he and his father will suffice to serve on the board without any outside director. Not to mention the fact that he lacks the knowledge to review the books and records of the corporation.

The Scope of Chapter Three

This chapter investigates the internal legal framework of joint-stock corporations in Saudi Arabia according to the CL regulating corporate institutions, corporate operations, and other corporate affairs. This chapter is intended to dissect the rules through an analytical and critical lens, rather than descriptive one, yet the description of the rules should be provided to comprehend better the detailed analysis and constructive criticism of the Law that follows. First, it starts with a straight procedural section about the incorporation requirements, including the incorporation of the one-person corporation. Second, it casts light on the role of the shareholder and the shareholder meetings through which they exercise most of their rights, yet it does not exhaust all shareholder

matters as most of them are examined in a later chapter in the context of the statutory protection for minority shareholders. Third, the chapter probes the rules of corporate management, including the composition of the board of directors, its meetings, and its duties and responsibilities along with the remuneration-rewards rules. Fourth, it casts light on the role of the external auditor, including its appointment, powers, and tasks. In the end, the chapter concludes with an in-depth analysis of the procedural and substantive rules regulating the close corporations.

Part I. Forming a Corporation

The incorporation of the joint-stock corporation requires the incorporators to undergo several statutory procedures that holistically aim at protecting the interest of not only the owners of the corporation but also third parties (e.g., creditors of incorporators).²¹⁷ Therefore, the Law, similar to its predecessor, sets forth precise, comprehensive rules that lead to the nullity as a punishment for the failure to obey these rules. Hereunder is a step-by-step explanation of the incorporation rules.

A. Drafting the Establishing Contract and Corporation's Articles of Association

The inception of the corporation commences as the founders sign off an establishing contract detailing major elements existed in every corporation. Such elements include the names of the incorporators, their addresses, the proposed name of their corporation,²¹⁸ its headquarter, its

† Hereinafter “the Law” refers to the Companies Law of 2015, unless otherwise noted.

²¹⁷ The Law defines an incorporator as “any person who signs the company’s articles of incorporation, applies for a license for incorporation, offers in-kind contribution upon its incorporation or participates in the incorporation with the intention to become an incorporator” *See* Article 56.

²¹⁸ In regulation of the name of joint-stock corporations, the Law mandates that the name be indicative of its purposes, and prohibits naming the corporation after a natural person’s name except in three instances: first, the purpose of the corporation is to utilize a patent registered in the name of such person; second, the joint-stock corporation decides to adopt the name of its subsidiary whose name permissibly includes a name of a natural person; or third, the joint-stock corporation is a result of transformation from any enterprise permissible to carry the name of natural person (e.g., partnership or limited partnership). *See*

purposes,²¹⁹ its share capital,²²⁰ the composition of the board of directors, its lifespan, its legal representative, and finally a pledge clause mandating that all signatories commit to undertaking all necessary strides to incorporate the business, including the advancement of the capital.²²¹

In addition to the written establishing contract,²²² incorporators are to draft the articles of association (bylaws) elaborating the rules by which the corporation will be running. Moreover, the bylaws encompass detailed guidelines for several corporate matters. For example, the document covers distribution of shares, their classes, issuance of shares, trading of shares, increase and decrease of the capital share, regulation of shareholder assemblies, management of the corporation, the number of directors, the length of their periods,²²³ the manner of board membership's termination or expiration,²²⁴ distribution of dividends, dispute resolutions, any opt-outs of corporate default rules, and the liquidation and dissolution of the corporation.²²⁵

In aid to meet these requirements, the Minister of Commerce and Investments issued directive templates for both documents to help the incorporators fulfill the requirements correctly and avert

Article 53 of the CL of 2015. However, many operating establishments, including joint-stock corporations, carry the surnames of their owners.

²¹⁹ Some business activities require special authorization from the competent agencies in charge of regulating and supervising these activities. *See infra* note 230.

²²⁰ *See infra* Chapter 3. Part I. C.

²²¹ *See supra* note 163, 164.

²²² The approach adopted by the Saudi legislature to require a contract at the outset and to recognize the separate personality for the corporation from its owners concurs with the view of corporation as “nexus for contracts.” According to this view, corporations are parties to contracts with third parties (e.g., suppliers, customers and employees) to carry out the main purpose of the business. In addition, the “nexus for contracts” concept results in the separation of the assets advanced to the corporation from the ownership of the corporation's owners. Therefore, the corporation, as the new possessor of these assets, is solely liable for the debts and liabilities arising from its operations. In fact, Article 52 of the Law reads that “[a] joint-stock company shall be solely liable for debts and liabilities arising from its activities.” *See REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 5 (Oxford Univ. Press 3rd. ed. 2017) (arguing that the economic view of corporation as “nexus of contracts” fails to distinguish between corporations and “other networks of contractual relationships”).

²²³ *See infra* Chapter 3. Part III. A. 1.

²²⁴ Article 68 (3).

²²⁵ *See supra* note 163, 164.

nullification of or delays in the incorporation process. Also, it sets the minimum information needed for third parties to assess the corporation accurately.²²⁶

After the incorporators draft and execute these documents, they are to file an incorporation request enclosed with the said incorporating documents to the Ministry of Commerce and Investments.²²⁷ Upon the verification of all documents, a license incorporating a joint-stock corporation is issued by a ministerial decision (MD No.1).²²⁸ Nevertheless, if the business purpose of the corporation itself requires a special license or official authorization by the competent agency regulating and supervising such a business,²²⁹ incorporators are to obtain such a license or authorization prior to the submission of the incorporation request.²³⁰

This ministerial license does not guarantee the incorporation but merely permits the incorporators to move forward with the process of share-capital raising and to hold the incorporation assembly.²³¹ Finally, after obtaining the MD No.1, the incorporators are to have both

²²⁶ See *supra* note 163, 164.

²²⁷ Article 57.

²²⁸ An important difference that is noticed in the Law is that the power to issue a “ministerial decision” is assigned to two organs: either the Minister or the Ministry. The former himself is solely empowered by the Law to compose a committee to temporarily supervise corporations with no board of directors (Article 69), to amend the nominal value of shares (Article 105.2), to issue the guiding forms for articles of incorporation and bylaws for each enterprise recognized by the Law (Article 225.1), and to adopt whatever necessary for the implementation of the Law (225.2). Any issue falling within the scope of these articles has to be regulated and decided upon by a ministerial decision signed only by the Minister. On the other hand, licensing the incorporation of joint-stock corporations (M.D No.1) and announcing the incorporation of joint-stock corporations (M.D No.2) are of the Ministry’s powers (Articles 62.1 and 65.1). Therefore, a ministerial decision may be issued by the Minister, his deputy, or any delegated department within the Ministry (e.g., the Companies Department).

²²⁹ Article 60 (1,2).

²³⁰ For example, if the business purpose of the corporation is to carry out telecom services, a ministerial decision licensing the incorporating of the business should be issued only after the business has acquired the required license from the Communications and Information Technology Commission, since it is the sole competent authority in charge of regulating and supervising the telecom sector in Saudi Arabia.

²³¹ See *infra* Chapter 3. Part I. B & C.

documents notarized by the competent authority.^{232 233} Failure to notarize these documents or any amendments to these documents gives rise to the nullity of the corporation and joint liability imposed upon the failing incorporators for any damages to the corporation, partners, or third parties.²³⁴

B. Share Capital

1. Share Capital Requirements

In building the corporation's capital, the Law requires a set of demands to be met.²³⁵ First, the Law presupposes that the capital suffices to embark upon the business purposes,²³⁶ yet the corporation's capital, in all cases, shall not be less than 500,000 Saudi Riyals (\$ 133,333).²³⁷ To ensure the seriousness of the incorporators and their solvency to carry out the business, the Law demands that at least 25% of the corporation's capital be advanced and paid up upon the incorporation.²³⁸

²³² For a long time, the competent authority was only the Notaries of the Ministry of Justice. Recently, the Ministry of Justice has licensed a number of lawyers to be also authorized notaries alongside the Public Notaries across the region.

²³³ In practice, the notarization requires incorporators to provide three documents: a letter for the Ministry addressing the Public Notary and authorizing the notarization; incorporation's resolution; and the bylaws as approved and stamped by the Ministry.

²³⁴ Article 12 (1, 2).

²³⁵ Building the corporate capital in close corporations differs from public corporations. In the latter, it is jointly regulated by the Capital Market Authority and the Ministry of Commerce and Investments because it involves initial public offerings. Such a difference is the requirement of underwriting. As far as close corporations are concerned, this thesis assumes only the incorporation process of close corporations. *See* Article 58.

²³⁶ Article 54.

²³⁷ No distinction is drawn between listed corporations and unlisted ones. On the contrary, the predecessor required that share capital of listed corporations be no less than 10 million Saudi Riyals (\$ 2,66 million), whereas the capital of unlisted corporation would not be less than 2 million Saudi Riyals (\$ 533,333). One may see the huge drop in the share capital as statutory encouragement for businesses to transform to or form joint-stock corporations. This form of entity is no longer a vehicle deployed for massive business projects, but it is now available relatively for all business objectives.

²³⁸ In the past, the paid-in capital required by the Law was at least 50% of share capital. Evidently, the lowering of the percentage of paid up share capital and the lowering of the minimum share capital reflect the leniency of the 2015 Law and the statutory encouragement to carry out business purposes in the form of joint-stock corporations.

Second, the corporate capital is to be divided into negotiable, nominal shares of equal value.²³⁹ The Law also requires that par value per share be 10 Saudi Riyals (\$ 2,66)²⁴⁰ unless otherwise permitted by the Minister.²⁴¹ Furthermore, the share capital (all or portion of it)²⁴² is to be banked to a company-under-incorporation account with an accredited bank in the region.²⁴³ The access to this account is reserved for only the board of directors after the declaration of the incorporation.²⁴⁴

Joint-stock corporations' shares have several statutory features. First, all shares, in general, have equal value.²⁴⁵ This helps in several ways: it eases the calculating process of voting during the shareholder assembly and eases the distribution process of dividends. Another feature is that they are indivisible vis-à-vis the corporation.²⁴⁶ Therefore, if a group of individuals possesses a share, they must select one of them to exercise the rights attached to this share. By the same token, all individuals are jointly liable for any obligation arising from the ownership of this share.²⁴⁷ Inheritance and gifts are a common cause for such devolution.

Last but not least, if some incorporators advance in-kind contributions (e.g., lands, buildings, cars),²⁴⁸ it is of the incorporators' responsibilities to ensure accurate evaluation of their shares.²⁴⁹ In addition, the ownership of shares issued against in-kind contributions is transferred only after a

²³⁹ Article 52.

²⁴⁰ It is unclear why the Law has set the par value at ten Saudi Riyals, yet going over past IPOs in the Saudi market, one may conclude that 10 Saudi Riyals has always fostered small investors and low-income people to enter the market and make profits out of these IPOs.

²⁴¹ Article 105 (2).

²⁴² In case the share capital is not paid up in-full, the remaining of share value must be paid within five years from the date of the issuance of shares. *See* Article 106 (2).

²⁴³ Article 59.

²⁴⁴ *Id.*

²⁴⁵ Article 52.

²⁴⁶ Article 105 (1).

²⁴⁷ *Id.*

²⁴⁸ Article 56.

²⁴⁹ In doing so, the Law requires that the incorporation request be accompanied with a report with an estimate of the fair value of these contributions that is executed by an appraiser or accredited valuator. *See* Article 61 for further procedural information.

payment-in-full value is made and full transfer of the ownership of their in-kind contributions to the corporation is completed.²⁵⁰

2. Share Capital Classes

In principle, the share capital of the corporation consists of “common” shares that entail equal rights for and obligations upon their holders.²⁵¹ Nonetheless, corporations may decide to issue another class of shares that entails different rights and obligations, which is known as “preferred” shares.

Under the Law, the issuance of preferred shares requires the following: first, the corporation’s bylaws allow the issuance of such a class; second, the extraordinary general assembly of the corporation votes in favor of the issuance of preferred shares.²⁵² In all cases, the Law recognizes preferred shares as non-voting shares, which do not entitle their holders to vote in shareholder general assemblies.²⁵³

Instead, preferred shares grant their holders the right to receive a higher percentage of the corporation’s earnings, provided that the corporation has set aside its statutory reserve.²⁵⁴ Holders of preferred shares are first in line to receive their portions, before any distribution of dividends to shareholders.²⁵⁵ In addition, since the preferred shares are non-voting shares, which cannot be cast

²⁵⁰ Article 106 (3).

²⁵¹ Further details and explanations of these rights and obligations are provided later in the next chapter under the umbrella of minority shareholder rights.

²⁵² The issuance of preferred shares involves an increase in the share capital of the corporation, which is one of few exceptional instances the Law sets a higher voting-passage percentage for than the default percentage stipulated in the Law for decisions by extraordinary assembly. *See infra* Chapter 3. Part II. A. 2. b.

²⁵³ Article 114.

²⁵⁴ The Law obliges joint-stock corporations to build a statutory reserve. In doing so, corporations must put 10% of its net profits by every year, and they may cease putting aside the 10% portion upon two conditions: first, the statutory reserve has reached 30% of the corporation’s paid-in share capital; second, the corporation’s ordinary general assembly votes in favor of discontinuing setting aside 10% of its net profits for the reserve. In other words, the board of directors may not make such a decision. *See* Article 129 (1).

²⁵⁵ Article 166 (1).

upon any corporate matter, the Law protects the interests of their holders in a variety of ways. For instance, besides the fact that they are first in line, the Law prevents the corporation from issuing any class of shares that would have priority over the existing preferred shares, or to modify their agreed-upon percentage of the corporation's net profits unless such issuance is approved by the holders of existing shares.²⁵⁶ Another protective aspect of this class of shares is that in the failure of the corporation to pay— for three consecutive years— the holders of these shares the percentage to which they are entitled, the Law grants these holders several temporary rights. They have the right to attend shareholder assemblies and cast their votes, or they may appoint a number of representatives of them as a class to the board of directors, proportional to their shares in the corporation's capital. Such a right continues until their overdue profits are paid in full.²⁵⁷

C. Incorporation Assembly

After notarizing the foundational documents, depositing the share capital into the under-incorporation bank account and issuing DM No.1, the incorporators must invite all subscribers to the incorporation meeting within 45 days from the date of MD No.1 with the proviso that there are at least three days between the date of the invitation and the date of the meeting.²⁵⁸ Every subscriber and incorporator have a statutory right to attend this assembly, irrespective to their shareholdings.²⁵⁹ For the validity of this assembly, the Law requires a quorum of subscribers

²⁵⁶ Such approval is obtained through a special committee consisting of prejudiced preferred-share holders, and meetings of this committee is held in compliance with the rules regulating extraordinary shareholder assemblies. *See* Article 89.

²⁵⁷ Also, this right is exercised through the special committee of prejudiced preferred-share holders as class. *See* Article 166 (2).

²⁵⁸ Article 62 (1).

²⁵⁹ This is a new rule the Law introduces in Article 62 (2). In the past, attending any sort of corporate assemblies was restricted to only shareholders of at least twenty shares. This reflects statutory recognition of minority rights and the necessity of raising its voice in shareholder assembly.

holding at least 50% of the share capital,²⁶⁰ and decisions are passed by an absolute majority of the shares represented in the meeting.²⁶¹ In the assembly, subscribers are to elect a chairperson, secretary and vote counter.

The incorporation assembly is held only once in the lifetime of the corporation. It takes charge of five statutory tasks.²⁶² First, it ensures that the statutory minimum of share capital, if not paid in full, has been advanced. Second, it confers the evaluation report of the in-kind contributions, if any.²⁶³ Third, it ratifies the final version of the articles of association (the constitution of the corporation).²⁶⁴ Fourth, it appoints members of the corporation's first board of directors and auditor if they have not been yet specified in the constitutional documents.²⁶⁵ Fifth, it deliberates and ratifies incorporation report of expenses and activities incurred and carried out by incorporators.

All in all, the incorporation assembly appears to be the practical kickoff of the business since it is empowered to finalize the business's constitution and select the members who will have access to the banked share capital.²⁶⁶

²⁶⁰ The Law goes farther to regulate cases in which such a quorum is not met. It requires a call for a second meeting and deems the meeting valid regardless of the how much of the share capital the attendees represent, provided that the meeting takes place after at least 15 days of the date of first one. To avoid this protracted procedure, the Law allows for the second meeting to be held after one hour of the period prescribed for the first meeting (one-hour rule), provided that the call for the first meeting contains what indicates that a second meeting will be held after one hour if case the first meeting is inquorate.

²⁶¹ By an exercise of imagination and application of logic, this rule may become problematic for close corporations in case the majority shareholder possess more than half of the share capital. That shareholder would unilaterally form and finalize "the constitutional documents" of the corporation.

²⁶² Article 63.

²⁶³ See *supra* Chapter 3. Part I. B.

²⁶⁴ In case there are substantive amendments to the articles of association (e.g., change of business purpose), the Law requires that it be approved by all subscribers attending the meeting.

²⁶⁵ See *supra* Chapter 3. Part III. A.

²⁶⁶

D. Declaration of Incorporation

The last stride in the incorporation process is the announcement of the incorporation. Within fifteen days of the conclusion of the incorporation assembly, the incorporators must submit a request for the announcement and enclose to the request three major documents: evidence of compliance with share capital requirements, the incorporation assembly's minutes and decisions along with the approved-by-assembly articles of association.

Upon confirming the completion of the incorporation's requirements, the Ministry issues a ministerial decision (MD No. 2) declaring the incorporation of a joint-stock corporation, and such resolution is to be posted on the Ministry's website.²⁶⁷ Members of the board of directors are to register the corporation in the Commercial Registry within a fifteen-day window from the date of announcing the incorporation of the corporation.²⁶⁸

MD No.2 breeds essential results. First, the corporation becomes immune against any action invalidating it for a violation of the Law or the articles of association, and such actions are not heard, provided that the announcement has been published and the corporation has been registered.²⁶⁹ Second, all expenses and activities executed by incorporators for the incorporation purposes are transferred to and become borne by the corporation, only.²⁷⁰

E. The Contractual View of the corporation and One-Person Joint-Stock Corporation

At the onset of the CL of 2105, Article two words the exact definition of the corporation in the superseded Law.²⁷¹ They both define the corporation as "a contract under which two or more

²⁶⁷ Article 65.

²⁶⁸ Failure to comply with the registration requirement, or negligence to announce any amendments to the articles of association is penalized by the Law with a fine not exceeding 500,000 Saudi Riyals (\$ 133,333). Article 213 (N).

²⁶⁹ Article 66 (1).

²⁷⁰ Article 66 2).

²⁷¹ See Article one of the Companies Law of 1965.

persons undertake to participate in an enterprise for profit, by contributing a share in the form of money, work, or both, and share profit or loss resulting therefrom.”²⁷² However, the Companies Law of 1965 required a contract between at least five individuals for the incorporation of the joint-stock corporation,²⁷³ and it disapproved of any form of one-person entity (joint-stock corporation or limited liability corporation) because such a concept contradicted the long-standing view of corporations as contractual relationships between at least two persons.²⁷⁴

The requirement of five individuals to incorporate a joint-stock corporation (or even two people to incorporate limited liability company) led people to gaming the system and circumventing the five-incorporator (in case of joint-stock corporations) or two-member (in case of LLCs) requirement by inclusion of sham shareholders and members to just meet the threshold requirement. This necessitated the adoption of the one-person enterprise since it was invented in part of coping with such gaming. In addition, as mentioned earlier the government needed to carry out several projects through corporate vehicles where it was the only owner.²⁷⁵ Therefore, the legislature realized the importance of the one-person entity, the need to depart the longstanding

²⁷² Article two of the Companies Law of 2015.

²⁷³ Article 48 of the Companies Law of 1965.

²⁷⁴ A respectable argument against the view of corporation as a contract by the Saudi legislature is introduced by Aljaber in his book [written in Arabic]. Aljaber argues that even though the contractual view of corporation might succeed in explaining the complexity of corporation in the past, it has, however, become incapable of explicating today corporations due to the major gaps between the corporate rules and the general principles of contract. For example, the contract founding the corporation not only produces mutual rights and obligations (as all contracts do) but also it creates a new separate legal person that has the full capacity and is financially independent. Also, the contract features that it can be modified by consent of the majority of the signatories to the contract, while the general principle of contract requires consent of all parties to modify it. Contracts in principle are fashioned with the aim to reconcile between conflicting interests of their parties, whereas all parties to the contract forming corporations share the same goal of profiting therefrom. Instead, he believes that the corporation should be regarded as a legal institution of special nature where the role of individuals is limited to accept or reject the entry to this institution. This gives grounds for the intervention of the legislator by setting forth mandatory rules to attain a cluster of economic and social goals. For further justification of this argument, see Aljaber, at 164–165. By the same token, this argument is all-encompassing as it justifies one-person entities.

²⁷⁵ See *supra* Chapter 2. Part II. B. 1.

view of the corporation as a contract, and the acceptance of the patrimony of affectation doctrine.^{276, 277}

In terms of the joint-stock corporations, the Law now requires only two persons, at least to submit the incorporation request—in principle and according to the contractual view of the corporation stated in Article two.²⁷⁸ Nevertheless, in exception to the statutory definition of the corporation, the Law permits the incorporation of the one-person corporation for a few persons.²⁷⁹ The first category to incorporate the one-person corporation—with no minimum share capital threshold— includes the state, public legal persons alongside state-owned corporations.²⁸⁰ The second category to incorporate the one-person corporation are corporations whose share capitals are no less than five million Saudi Riyals (\$ 1,33 million). Consequently, the natural person may not incorporate the one-person joint-stock corporation.²⁸¹

²⁷⁶ Similar to the recent acceptance of the Saudi Companies Law of 2015 of one-person entity, the United Arab Emirates (UAE) just approved and accepted the single-owner entity. *See* Article 8 (3) of the UAE Federal Law No.2 of 2015 on Commercial Companies, (“Notwithstanding the provision of Clause 1 of this Article [“a company is contract under which two or more persons . . .”], a company may be incorporated or held by a single person in accordance with the provisions of this Law.”)

²⁷⁷ The refusal of one-person entity in favor of the contractual view of corporation according to the concept of unity of patrimony (a person is answerable for all his debts and obligations with all his present and future assets, and he or she cannot earmark some of the assets for a specific debt, which is known as patrimony of affectation) is common in the corporate laws of several Arab countries such as Egypt, Lebanon, Syria, Kuwait, and Oman. *See* HIEWA I. ALHAIDARI, ONE PERSON LIMITED LIABILITY COMPANY: COMPARTIVE STUDY, 121–122, (AL-HALABI LEGAL PUB. 1st. ed. 2010).

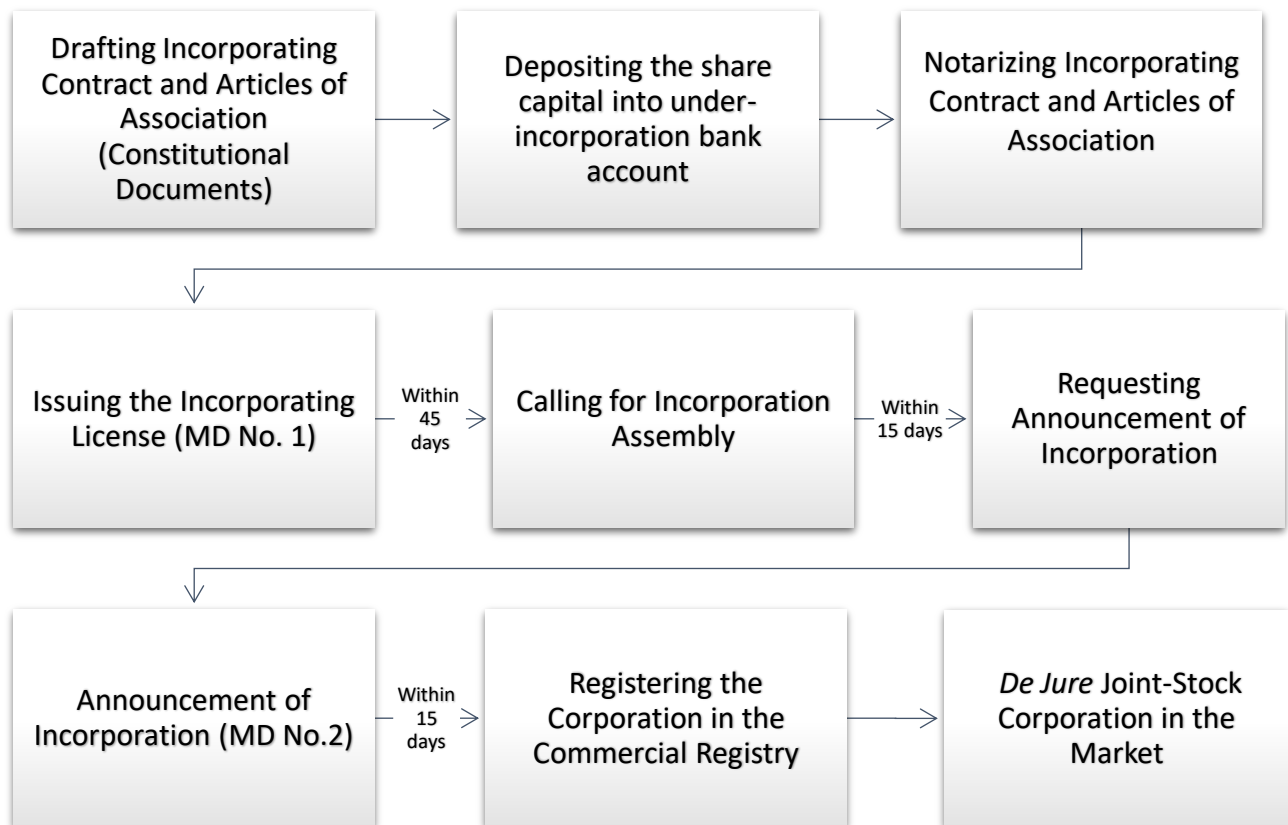
²⁷⁸ In case shares of a joint-stock corporation descend to one shareholder that does not satisfy the statutory exception for one-person joint-stock corporation stated in Article 55(e.g., by involuntary means such as inheritance or a voluntary one such as a purchase of these shares), the Law grants this corporation a one year period to rectify its condition in compliance with the Law. Such rectification may be in one of the following forms: conversion to one-person limited liability, inclusion of at least one shareholder, or transfer of the shares’ ownership to a legal entity that is allowed by law to incorporate one-person joint-stock corporation. Failure to take one of these corrective actions during the statutory one-year window results in termination of the corporation by the force of law. *See* Article 149.

²⁷⁹ Article 55.

²⁸⁰ Examples of state, legal persons are the Public Investment Fund and the Public Pension Fund. Examples of State-owned Corporations are the Saudi Railways Company, and the Saudi Arabian Military Industries Company

²⁸¹ However, the Law recognizes the right of natural person to incorporate one-person entity, in exception to the principle, only in the form of limited liability company. *See* Article 154 (1).

F. Incorporation Process Design



Part II. Shareholders

Shareholders are of the foremost bodies (shareholders and board of directors) the Law recognizes in the regulation of the corporations.²⁸² They are indeed the corporation's owners who due to the structure of the joint-stock corporation are divested of their right to operate and run the business. Nevertheless, they as a class enjoy a supreme power and arguably have the upper hand over a bundle of corporate matters as explicated hereunder.

The question of which body has the superior power emerges in most corporate governance studies. Some arguments favor the management organ,²⁸³ while others align with the shareholder as a class.²⁸⁴ Nonetheless, the advocates of both arguments agree upon the importance of both institutions, and they would not vest a great deal of power in one body without being checked.²⁸⁵ Therefore, corporate governance comes to enhance the legal and economic environment of the

²⁸² Most of shareholder rights, the statutory protection of them, and other shareholder-related research questions are explained in a separate part later in this thesis.

²⁸³ *E.g.*, Delaware with its pro-management corporate law and judiciary is arguably on the top of the advocates' list that favor corporate management and thus entrust them with wider powers over corporate affairs as a means of maximizing shareholder value. Not to mention the pervasive influence of Delaware corporate experience over a wide range of jurisdictions. *See generally*, William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 663–68 (1974); Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, n.61 (2002) (“All state corporate codes provide for a system of nearly absolute delegation of power to the board of directors, which in turn is authorized to further delegate power to subordinate firm agents.”); Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 674 (2006); William W. Bratton; Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and the Modern Corporation*, 34 J. CORP. L. 99, 152 (2008).

²⁸⁴ A prominent proponent of the view of shareholder superiority and power over the management, Professor Lucian Bebchuk of Harvard Law school, who has written several commonly-cited articles in support of shareholder superiority and power over the management. *E.g.*, Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675 (2007); Lucian A. Bebchuk, *Reply: Letting Shareholders Set the Rules*, 119 HARV. L. REV. 1784 (2006); Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005).

²⁸⁵ *See* Angualia Daniel, *Balance of Power between Shareholders and the Board in Corporate Governance* p.4 (2010) (attributing the collapse of the corporation to “[t]he lake of proper check on such powers”) (Available at SSRN: <https://ssrn.com/abstract=1612962> or <http://dx.doi.org/10.2139/ssrn.1612962>) (last visited Oct. 12, 2017).

corporations and strike a balance between the two internal organs. Distinctive thoughts of the separation between ownership and control generate different corporate governance models that vary in their views and boundaries of the rights and responsibilities of each body.²⁸⁶ Of course, the variations and differences among these models stem from the fact that each model has been designed to reflect and suit the corporate environment it develops in.²⁸⁷ Such differences between these models are the characters in the corporate arena,²⁸⁸ the ownership patterns,²⁸⁹ the sophistication of the capital market,²⁹⁰ the regulatory framework of the country,²⁹¹ and the sorts of corporate powers every organ enjoys.²⁹²

As far as the Saudi corporate governance concerns, one may extrapolate from what has been explained earlier that the concentrated ownership structure (with the strong presence of the state) involves corporate governance that leans toward shareholders and empowers them.²⁹³ Evidently, the shareholders capitalize the corporation, incorporate it, decide the remunerations for its board members, and formulate its policies toward the corporation's ends.²⁹⁴ The CL of 2015, however,

²⁸⁶ The most notable corporate governance models in corporate scholarships are the U.S. model, the Japanese model, and the German model.

²⁸⁷ See REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* ch. 3 (Oxford Univ. Press 3rd. ed. 2017) (attributing the variation of corporate governance across the world to ownership structure, coordination and information costs along with different levels of enforcement of corporate laws).

²⁸⁸ For example, the German model, copied by Brazilian corporate law as well, adopts a two-tier board system that includes a board in charge of the executive role and another in charge of the supervisory role, whereas the U.S. and Japanese models have one board for the management of the corporation. Other jurisdictions (e.g., France and Italy) grant corporations the option to select either board system. See REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 50 (Oxford Univ. Press 3rd. ed. 2017)

²⁸⁹ See *supra* Chapter 2. Part II.

²⁹⁰ See *supra* Chapter 2. Part II. A.

²⁹¹ See *supra* Chapter 2. Part II. A.

²⁹² E.g., REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 49 (Oxford Univ. Press 3rd. ed. 2017) ("In countries where controlling shareholders are common, *appointment* and *decision rights* are often relatively strong, enabling such shareholders to exert influence directly over the management.")

²⁹³ See *infra* Chapter 3. Closing Analysis.

²⁹⁴ See L.C.B. GOWER, *PRINCIPLES OF MODERN COMPANY LAW* 150 (Stevens. 3rd. 1969)

draws, in a very detailed way, the powers' limits of each body and the statutory duties assigned to it. Accordingly, members of the board are agents serving the interests of the shareholders as a class.

It is worth reminding that close-corporation shareholders oftentimes, if not always, serve as directors of the corporation,²⁹⁵ so it is rare to trigger the issue of separation and superiority of power in such situations due to the absence of the agency problem it causes between the shareholders (principals) and corporate managers (agents). Nevertheless, the issue shifts to bisect shareholders into minority shareholders (principals) and controlling shareholders (agents). Striking a statutory balance between the two appears to be critical as to neither over-empower the controlling shareholders in a way that results in oppression nor to overprotect the minority shareholders in a way making them the controlling ones.

To balance these powers, the Saudi Law articulates the rights and the duties of both bodies in terms of substance and form. Moreover, the Law considers that both bodies (the board of directors and shareholder as a class through their statutory assemblies) compose the management of the corporation. To elaborate on the management portion of the shareholders as a class, the emphasis is placed upon the channels through which they perform their statutory roles: shareholder general assembly and audit committee.

A. Shareholder General Assembly

The Law obligates the joint-stock corporations to have two sorts of general assemblies (ordinary and extraordinary shareholder assemblies), where shareholders raise their voice and

²⁹⁵ It is also known as “compliance board”, where the company only has the board to fulfil a legal requirement, as opposed to “quasi-independent board” consisting of directors with no ties to the corporation apart from their capacities as directors. *See Catherine Bromilow & John Morrow, Family Business Corporate Governance Series: What is a Board’s Role in Family Business?* PRICEWATERHOUSECOOPERS LLP (June 2014).

exercise their statutory rights. The Law elaborates on shareholder assemblies and the rules governing them, as these assemblies are regarded as the parliament of the corporation whose shareholders reserve the right to decide a wide range of corporate affairs the Law assigns to them as a class. As these assemblies differ from each other in terms of substance, they, however, enjoy some statutory similarities in terms of the form these meetings take. This research, therefore, bisects the regulatory framework of the shareholder assemblies into two categories: statutory similarities and statutory differences.

1. Statutory Similarities

a. Assembly Call

The Law obligates the board of directors to call for all shareholder general assemblies requires the chairperson of the board to preside these assemblies.²⁹⁶ The invitation to shareholder meetings may be required by law,²⁹⁷ or based on a request from the corporation's auditor,²⁹⁸ the audit committee,²⁹⁹ or a number of shareholders representing all together no less than 5% of the corporation's share capital.³⁰⁰

Another similarity between shareholder assemblies is that the invitation to attend the assembly is to be published in a daily newspaper circulated in the province where the headquarter domiciles.

²⁹⁶ In the absence of the chairperson, the vice-chairperson is to preside the shareholder meeting, or any member designated by the board of directors in the absence of the two. *See* Article 86 (1).

²⁹⁷ *See infra* Chapter 3. Part II. A. 2. a.

²⁹⁸ *See infra* Chapter 3. Part IV. C.

²⁹⁹ *See infra* Chapter 3. Part II. B. 2.

³⁰⁰ In addition, the Law specifies several conditions where the call for an ordinary general shareholder assembly is by not the board of directors but a resolution issued by the Competent Authority, the Ministry of Commerce and Investment: in case the board's failure to conduct the statutory meeting according to Article 87; failure of the board to satisfy the minimum number of members to conduct a valid meeting; in case of violation of the Law or the corporation's bylaws; in case of mismanagement of the corporation; in case of the board's failure to call for the meeting within fifteen days upon request by the audit committee, auditor, or shareholders representing at least 5% of the corporation's share capital. The call is based upon a request by shareholders representing 2% of the corporation's share capital, and the Competent Authority is to send out the call within 30 days from the date of the request. *See* Article 90 (2,3).

This invitation must be published ten days prior to the date of the meeting. As an alternative, the meeting's invitation may be mailed out by registered mail. A copy of the meeting call and agenda must be provided to the Competent Authority during the publication period.³⁰¹

b. Assembly Minutes

Corporations are to maintain minutes of every shareholder meeting. Such minutes include the number of shareholders attending the assembly (or their delegates), the shareholdings they represent personally (or by proxy), decisions made (including the number of assenting votes and dissenting ones), and a synopsis of the meeting deliberations. The Law requires that the minutes of every shareholder assembly be recorded and kept following every meeting, and they have to be signed by the chairperson of the assembly, its secretary and the vote counter.³⁰²

c. Voting System and One-Share-One-Vote Rule

Shareholders are empowered to fashion their voting system in terms of the required quorum for issuing resolutions upon corporate affairs.³⁰³ For example, they may stipulate in the bylaws that a vote of supermajority is required for deciding directorial remunerations opting out of the default rule (requiring a simple majority vote at an ordinary general shareholder meeting). Failure to adopt opt-out provisions in the corporation's bylaws implies the acceptance and thus adherence to the Law's default rules.

The shareholder's discretion to design the voting manner, nonetheless, is not absolute. The Law imposes several restrictions on the exercise of this power. For instance, alterations to the default quorum and voting-passage requirements in shareholder assemblies.³⁰⁴ In addition, the Law imposes the one-share-one-vote rule as it underscores the equality of shares in terms of the rights

³⁰¹ Article 91.

³⁰² Article 97.

³⁰³ Article 95 (1).

³⁰⁴ See *infra* Chapter 3. Part II. A. 2.

and obligations they produce (except for preferred shares).³⁰⁵ Also, the Law mandates that the cumulative voting be followed in appointing directors to the corporation's board. Opt-out provisions concerning these corporate affairs are null and void.³⁰⁶

d. Online Assembly and Voting (Virtual Meetings)

The Law has taken an unprecedented step allowing the corporations to conduct shareholder meetings through cutting-edge technology.³⁰⁷ Evidently, this permission, in theory, encourages shareholders to play their roles without bearing a high cost of coordination and information. To utilize this statutory permission, the Ministry of Commerce and Investment sets forth the implementing rules therefor.³⁰⁸ Such rules are that the shareholder's participation has to be via instant visual and audio transmission of the shareholder assembly.³⁰⁹ Also, a shareholder is to be enabled in the online meeting to effectively participate, express attitude, discuss and cast votes upon the meeting agenda.³¹⁰ In addition, close corporations may allow shareholders to cast their votes online even if they do not attend the assembly, provided that online voting is available before and during the shareholding meeting (no delegates required). Plus, the online voting period is open for no less than three days before the date of the meeting, and the online voting upon every item of the meeting agenda is halted as the discussion and voting on that item conclude.³¹¹ Most importantly, the online voting and online meeting do not subrogate the holding of the in-person meeting at the venue specified in the invitation, nor do they deprive the shareholder of attending

³⁰⁵ An excessive explanation about these rights is provided in the next chapter.

³⁰⁶ Further analysis of the cumulative Voting approach adopted by the Law is provided later under the minority shareholder representation in the boardroom as part of the statutory protection of this class.

³⁰⁷ Article 86 (3).

³⁰⁸ See *supra* Chapter 2. Part I. B. 1.

³⁰⁹ See the Organizing Rules for Unlisted Joint-Stock Corporations, Article 8 (1.A).

³¹⁰ *Id.* Article 8 (1.B).

³¹¹ *Id.* Article 8 (2.A, B, C, D).

in person.³¹² In other words, the physical shareholder meeting is always compulsory, and the online meetings and voting are optional alternatives for the corporation to ease the exercise of the shareholders' rights, and they do not substitute for the physical meeting, making it a hybrid physical/online shareholder meeting.³¹³ The board of directors should adopt whatever necessary to verify shareholders' identities,³¹⁴ and it may also communicate the invitation to the meeting online in exception to the newspaper publication or registered mail method.³¹⁵

e. Compliance with Articles of Associations

The possession of the corporation's shares implies that the shareholder is bound by the constitutional documents and all decisions made through the shareholder assemblies so long as they comply with the corporation's articles of association, regardless of the shareholder's presence and absence or his agreement and disagreement to these decisions. However, if the decision is made to the contrary to the corporation's articles of associations, such a decision is deemed void and null.³¹⁶ For example, if the articles of association or the corporation's bylaws set a higher quorum than what is required by the default rule for the validity of general shareholder meeting, this quorum has to be satisfied. Otherwise, the meeting is invalid, so are its decisions.

³¹² *Id.* Article 8 (3).

³¹³ From a shareholder perspective, the requirement of holding in-person meeting offers protection for less tech-savvy shareholders to raise their concerns and direct questions to the management directly. From the management's point of view, however, this requirement appears to be expensive and time-consuming as hosting physical meetings often involve room-renting and catering costs, which could be avoided by holding online-only meetings. In addition, shareholders are less likely to confront and investigate directors in online-only meetings, which relieve the latter from awkward situations. For further information, see Robert Richardson, Glass, Lewis & Co., *Virtual-Only Shareholder Meetings: Streamlining Costs or Cutting Shareholders Out?* Harvard Law School Forum on Corporate Governance and Financial Regulation (Nov. 30, 2017) (casting light on the trend that a number of public companies in the U.S. hold virtual-only shareholder meetings with no in-person meetings), <https://corpgov.law.harvard.edu/2017/11/30/virtual-only-shareholder-meetings-streamlining-costs-or-cutting-shareholders-out/>, (last visited: Dec. 1, 2017).

³¹⁴ *Id.* Article 9.

³¹⁵ Without prejudice to Article 91 of the 2015 Law (explained earlier in Chapter 3. Part II. A. 1. a). The Organizing Rules for Unlisted Joint-Stock Corporations, Article 11.

³¹⁶ Article 98, 99.

2. Statutory Differences

The Law stipulates that every joint-stock corporation have two kinds of general shareholder assemblies (ordinary and extraordinary ones), each of which is entrusted with a cluster of statutory obligations and powers. The differences between these assemblies stem not only from the duties and powers allocated to them but also from the varying statutory quorum prerequisite for the validity of each assembly as explained hereunder.

a. Ordinary General Shareholder Assembly

The call for ordinary general shareholder assembly may be either statutory or necessary. To clarify, every joint-stock corporation must hold an ordinary general shareholder meeting at least once a year.³¹⁷ This is the statutory meeting required by law (regardless of the urgency to convene or not), so failure to comply with it is sanctioned with a monetary penalty not exceeding 500,000 Saudi Riyals (\$133,333).³¹⁸ However, sometimes the corporation needs to decide on some corporate matters on which only the shareholders have the power to decide, such as the appointment to the board of directors. In this case, the board of directors, as put in charge of calling for shareholder meetings,³¹⁹ invites shareholders to attend an “urgent” shareholder meeting.

The Law sets forth a default quorum for the validity of this assembly. It requires the attendance of shareholders representing at least 25% of the corporation’s share capital.³²⁰ However, the Law leaves room for shareholders to set a higher percentage for the quorum in the articles of association on the condition that the quorum does not require more than 50% of the corporation’s share

³¹⁷ To be specific, the statutory meeting must take place within the six months following the end of the corporation’s fiscal year. *See* Article 87.

³¹⁸ Article 213 (H).

³¹⁹ *See supra* Chapter 3. Part II. A. 1. A.

³²⁰ Article 93 (1).

capital.³²¹ On the other hand, the passage of resolutions in ordinary general shareholder assemblies requires the approval of only an absolute majority (50+1) of the shares representing in the assembly. Again, shareholders have some discretion to stipulate a higher percentage in the corporation's bylaws.³²²

In principle, shareholders through the ordinary assembly have powers over all corporate affairs. Such affairs are, *inter alia*, the assignment and removal of a member of the board of director,³²³ the authorization of related-party or self-conflicted transactions by a member of the board of directors,³²⁴ the filing of the shareholder derivative suit,³²⁵ the approval of the financial statements and annual reports,³²⁶ the distribution of surpluses,³²⁷ the appointment and remuneration of the auditor,³²⁸ the formation of the audit committee,³²⁹ and any other corporate matter that is not part of the corporation's bylaws.³³⁰

Since the percentage for quorum and passage of the resolutions are not that high along with the fact that amendments to the corporation's constitution are critical, the Law—in protection of the major corporate affairs—excludes the powers to amend the corporate constitution (the articles of association or bylaws) from the ordinary general shareholder assembly. Instead, the power is assigned to the second type of assemblies, the extraordinary general shareholder meeting.³³¹

³²¹ If a shareholder meeting is inquorate, the Law requires calling for a second meeting within a month from the date of first meeting. The invitation is to follow the rules explained in Chapter 3. Part II. A. 1. a. The second meeting is deemed valid, irrespective to meeting the required quorum or not. *See* Article 93 (2).

³²² Article 93 (2).

³²³ Article 68 (3).

³²⁴ Article 71 (1).

³²⁵ Article 97.

³²⁶ Article 128.

³²⁷ Article 130 (3).

³²⁸ Article 133 (1).

³²⁹ *See infra* Chapter 3. Part II. B.

³³⁰ Article 87, 88.

³³¹ Article 87.

b. Extraordinary General Shareholder Assembly

The corporate articles of association symbolize the constitution of the corporation. Constitutions often characterize as rigid in terms of the statutory procedures followed in amending or abrogating any of their texts, so supermajorities are of the foremost requirements to make such constitutional changes due to the significance of constitutions and their roles in the stability and continuity of the countries they come to organize. By analogy, due to the important details and organizational frameworks in the bylaws, corporate laws realize this significance and thus require another sort of shareholder assembly for amendments to these rules. The Law requires an extraordinary general shareholder assembly to be conducted for any of the corporation's core affairs arranged by and stipulated in the corporation's articles of associations.³³² Such corporate matters are the issuance of new shares,³³³ voluntary dissolution,³³⁴ issuance of preferred shares,³³⁵ conversion of common shares to preferred shares or vice-versa,³³⁶ issuance of debt instruments or *Sukuk* (Islamic bonds) that are convertible into shares,³³⁷ decrease of the capital share,³³⁸ increase

³³² However, there are some statutory exceptions to the assembly's power that cannot be modified. For example, change of the corporation's nationality and relocation of the corporation's headquarter outside the country are forbidden and shareholders cannot take such decisions. *See, e.g.*, Article 88 (A, B, C, D).

³³³ *See infra* note 339.

³³⁴ Article 94 (4).

³³⁵ Article 114.

³³⁶ Article 114.

³³⁷ In other words, issuance nonconvertible debt instruments and bonds falls within the powers of the board of directors, with prejudice to the corporation's bylaws. *See* Articles 121–125 for further knowledge of the regulatory framework of issuance of debt instruments.

³³⁸ One way to cope with losses, corporations may decrease their share capitals. Also, a decrease of the corporate share capital may occur if it is in excess of the corporate needs. Such a decision has to be made after shareholders being informed about the justifications for such a step by reading the corporate auditor's report including the liabilities and effects entailing such a decrease. *See* Articles 144–174 for further regulations regarding share capital decrease.

of the capital share,³³⁹ usage of provisional reserve,³⁴⁰ and repurchase of shares.³⁴¹ Also, if the corporation decides to opt out of the default quorums or the default resolution-passing percentage, such a decision must be approved by the extraordinary assembly.³⁴² Above all, it falls within its powers the right to deliberate and decide on all corporate matters that are delegated to the ordinary assembly.³⁴³

For the validity of extraordinary assemblies, the Law mandates a quorum of shareholders with no less than 50% of the share capital be satisfied.³⁴⁴ The Law permits the corporation to adopt a higher quorum, provided that it does not require more than 75% of the share capital.³⁴⁵ Such an opt-out is to be penned in the corporation's bylaws.³⁴⁶ The extraordinary assemblies' decisions are issued upon at least a two-thirds of the majority vote of the represented shares.³⁴⁷ Nevertheless, there are several stances the Law singles out and requires a third-quarter majority vote of the represented shares for the passage of resolutions related to these cases: the increase or decrease of

³³⁹ The Law specifies a several methods that may be utilized by joint-stock corporations to increase their share capital, such as issuance of new shares. In addition, it presupposes for the increase of share capital that the corporation's share capital has been completed and paid in full, and grants current shareholders preemptive rights. *See* Chapter seven of the joint-stock corporation's Part (Articles 137–143) for more regulations of this matter.

³⁴⁰ Article 130 (2).

³⁴¹ The corporation's repurchase of its shares is one of the ways (Article 146) the corporation utilizes to decrease its share capital, which is explained to be the right of the extraordinary assembly only. *See supra* note 338.

³⁴² Article 95 requires that a corporations' bylaws prescribe the voting system for their assemblies. If not, they abide by the corporate law default rules. Amendments of such rules or opt-outs of default rules must be approved by the extraordinary assembly.

³⁴³ Article 88 (2).

³⁴⁴ In case the quorum required by law or stipulated in the corporation's bylaws is not satisfied, the Law asks for a second meeting according to what is stated in note 321. However, the Law does not validate the second meeting if it does not the required quorum. Instead, it requires another call for a third meeting that is valid regardless the shares represented in the meeting. Calls for the second meeting and third meeting, if needed, is to follow the rules prescribed in Article 91.

³⁴⁵ Article 94 (1).

³⁴⁶ Articles 94 (1).

³⁴⁷ Unlike ordinary assemblies, the Law does not allow corporations to modify this resolution-passing percentage requirement. *See* Article 94 (4).

the corporation's share capital, extension of the corporation lifetime, voluntary dissolution of the corporation prior the expiry date stipulated in its bylaws, or the merger with another corporation.³⁴⁸

B. Audit Committee

Reviewing and accessing all corporate reports and records are of paramount importance to the shareholder's rights in joint-stock corporations. Such a right is indispensable and cannot be detached from the roles played by shareholders. However, the exercising of this right may require know-how that some shareholders may lack to deal with corporate affairs, mainly financial ones. The more the corporation expands its business and becomes sophisticated the more complex understanding and reading its reports is. For this reason, the Law encourages shareholders to delegate their supervisory roles to a handful of experts who become the shareholders' eye inside the corporation.

1. Formation

It is for the ordinary shareholder general assembly to organize a committee and deputize its members to monitor the corporation's affairs and activities.³⁴⁹ The board is to facilitate its mission and must not hinder its work.³⁵⁰ To form the committee, the Law asks not to appoint to it an executive member of the board for the sake of integrity and independence of the committee. The shareholder assembly may appoint up to five members to the committee, and it may not have less than three members. These members may be insiders or outsiders.³⁵¹ The resolution of forming the committee should specify its duties, its manual, and its members' compensations.³⁵² The validity of committee meetings requires the attendance of a majority of its members. The passage of

³⁴⁸ Article 94 (4).

³⁴⁹ Article 101.

³⁵⁰ Article 103.

³⁵¹ Article 101.

³⁵² Article 101.

resolution involves the approval of the attending majority, and the chairperson has the casting vote in case of a tie.³⁵³

2. Powers and Responsibilities

This committee has access to all corporate records and documents, and it is entrusted with the right to demand clarification from the board of directors or the executive branch. It may also request the board of directors to call for a shareholder assembly.³⁵⁴

In return, members of audit committees are to probe and scrutinize the corporation's financial statements and reports. The audit committee is also supposed to evaluate the internal control in the corporation and provide its detailed opinion about it. The committee's opinion and report of its work is to be deposited in the corporation's headquarter and copied made available to shareholders alongside being recited to shareholders at their general assembly.³⁵⁵

Part III. The Board of Directors

A key feature of the corporation that makes it stand out among other enterprises is the separation between ownership and control or the so-called “delegated management” feature. Unlike partnerships (where owners of business actively participate and engage in its management), the structure and the function of corporations necessitate the separation between ownership and control rights, given that corporations generally are cut off to undertake massive projects requiring huge capitals a handful of people cannot build by themselves.³⁵⁶ Therefore, corporate laws worldwide agree on the importance of corporate governance structure, yet they differ in terms of

³⁵³ Article 102.

³⁵⁴ *See supra* Chapter 3. Part II. A. 1. a.

³⁵⁵ Copies of the committee's report is to be available at the headquarter at least ten days before the shareholder assembly. *See* Article 104.

³⁵⁶ *See* REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 11—12 (Oxford Univ. Press 3rd. ed. 2017) (adding that majority or unanimity approval rule that may work in partnerships are difficult to be applied to corporations “with numerous and constantly changing owners . . .” due to the high cost of information and coordination).

the powers vested in the corporation's institutions (shareholders and board of directors). That results in two different corporate governance systems, shareholder-centric and director-centric corporate governance systems.

The Saudi Companies Law elaborates on the governing rules of the board of directors, setting an unprecedented presence of corporate governance principles, such as trust, integrity, accountability, openness, commitment to the corporation, disclosure, and transparency. These principles are decoded into a comprehensive set of rules governing all aspects of the corporate board. Such aspects are the composition of the board (including appointment, removal, and qualifications of the board's member),³⁵⁷ specific duties and responsibilities of the board, board meetings, and rewards and remuneration of the board's members. They all together set an exceptional division of the internal powers among corporate participants in the corporation by rules, rather leaving these matters to be decided on by contractual arrangements.

A. The Composition of the Board

The Law sets forth stringent rules governing the appointment of directors, their removal, the number of directors, and the separation of CEO and chairperson.

³⁵⁷ The Law does not require a director to have a certain set of qualifications. However, for public corporations, the Corporate Governance Regulations mandates that a director be professionally capable to lead, have the necessary knowledge along with skills to perform directorial tasks, and enjoy physical fitness. *See* Article 18 of the Corporate Governance Regulations.

1. Appointment to the Board

The power to appoint a member to the board of directors as shown earlier is vested in the shareholder general assembly.³⁵⁸ Shareholders elect their representatives in the corporation's management.³⁵⁹ Otherwise, the Law permits shareholders to nominate themselves to the board.³⁶⁰

The appointment resolution to the board should also include the time duration of the member on the board. Such duration, nevertheless, is not to exceed three years.³⁶¹ This stringent rule of the Law ensures a constant change in corporate management and brings new blood to the boardroom and the management team.³⁶² The only exception to this rule is when the appointment of directors is made by the incorporation assembly.³⁶³ This is the only exception that the Law allows the incorporation assembly to appoint directors to the board for terms that do not exceed five years

³⁵⁸ However, the Law in specific, rare situations (e.g., the death or resignation of a board member) allows the board to appoint a member to temporarily fill the vacancy on the board. The exercise of this exceptional right requires the following: the board selects a member based on the number of votes received by each candidate; the member has adequate competency; the appointment is to be reported to the Competent Authority within five days of the appointment; the appointment is referred to the ordinary general assembly in its first meeting following the appointment; and the new member is appointed to complete the term of the preceded member, and not appointed to a new term. *See* Article 70 (1).

³⁵⁹ The Law does not specify any qualifications for the board's membership. However, the Corporate Governance Regulations of public corporations sets forth several conditions for the membership of the board. Such conditions are the ability to lead, ability to guide, competency, financial knowledge, and physical fitness. These conditions are of paramount importance to ensure effective and efficient management. *See* Corporate Governance Regulations, Article 18. Furthermore, given the fact that family corporations, listed or not, in the region represent the major employers in the private sector alongside the uncertainty and instability of family businesses and thus affecting the Saudi labor market (specially some of family businesses have thousands of workers), the author tends to the importance to have labor representation in the board of directors of corporations that unlisted and the number of their workers are large due to the vital role and positive contribution of these corporations in job security and social welfare of society. Worker codetermination may be an effective solution to make close corporations adopt the best practices of corporate governance. However, determining the threshold of employees needs further a thorough empirical study of these corporations and the size of their labor element in order to set an optimal threshold that guarantees protection of the vast majority of labor market. *See* Abdulrahman N. Alsaleh, *Saudi Family Businesses upon their Founders' Death* (2015) (Unpublished L.L.M. Thesis, University of Southern California) (on file with the author).

³⁶⁰ Article 68 (2).

³⁶¹ Article 68 (3).

³⁶² However, the default rule allows shareholders to re-elect the members unless the corporation articles of association opts out of it. *See* Article 68 (3).

³⁶³ Article 63 (D).

during the lifetime of the corporation. This exception provides the corporation with the stability of management in its beginnings.

Another statutory constraint on the appointment of directors is that the Law sets forth absolute minimum and maximum of the number of directors the board may have.³⁶⁴ As the corporation's bylaws must indicate, *inter alia*,³⁶⁵ the number of corporate directors, this number must not be less than three directors, and not be more than eleven directors.³⁶⁶ Such a constraint, one may extrapolate, has a twofold aim: Joint-stock corporations are generally vehicles for mid-sized and large-scale projects with large capitals, so one or two directors may not be able to monitor the business efficiently and supervise its executive officers. Also, the prohibition of appointing more than eleven directors aims at preserving the corporation's wealth and prevent any exploitation or exhaustion of its fortune alongside the fact that a bigger board may have more conflicts and clashes among its members in a way that adversely impacts the operation of the corporation.³⁶⁷

If the shareholder general assembly fails to compose the board and appoint its members, the Law requires that the Competent Authority be notified. Upon notification, the Minister can compose a committee to temporarily run and supervise the corporation and call for an ordinary general assembly within three months of the formation of the committee to compose a board of their representatives.³⁶⁸ Such cases may be a result of severe tensions and clashes among

³⁶⁴ In the past Law, there was no statutory maximum on the number of directors a corporation would have, leaving it to be decided by corporate bylaws. An argument was advanced as setting no caps on the size of the board might be source of abuse by corporate controlling shareholders and senior officers, which called for statutory reform. *See* Almajid, footnote 844.

³⁶⁵ *See supra* Chapter 3. Part I. A.

³⁶⁶ The eleven-director cap was first introduced by a non-binding rule in the Corporate Governance Regulations issued by the Capital Market Authority in 2006, which the Law has adopted transformed into a mandatory rule in Article 68 (1).

³⁶⁷ AHMED ALKHABTI & HISHAM ALSSEBT, الوجيز في أحكام الشركات في النظام السعودي الجديد [THE COMPENDIUM OF CORPORATE RULES IN THE NEW SAUDI LAW] p. 186 n. 1 (Dar AlEjadh 2017).

³⁶⁸ This rule also applies to cases when all members of the board offer their resignations at the same time. *See* Article 69.

shareholders that bog down the appointment of directors. This rule appears to be protective of the corporation's operations and stakeholders (e.g., creditors and workers).³⁶⁹

2. Removal of Directors

As the shareholder general assembly has the right to appoint members to the board, it is also empowered with the right to remove any member from the board. The removal may be for cause or without cause at any time.³⁷⁰ The removal of the directors may include all members or some of them.³⁷¹ The right to remove a member from the board is a statutory right that may not be limited or excluded.³⁷² In other words, if the articles of association stipulate that a certain member may not be removed or may be removed after serving on the board for a specific duration, such a stipulation is unlawful and thus void.³⁷³ No member of the board is immune from removal. In all cases, the removed member has the right to seek compensatory damages from the corporation if the member successfully shows that the removal right is exercised without proper cause or at an inappropriate time.³⁷⁴

3. Resignation of Directors

On the other side, the Law asserts the right for members of the board to resign from the board on the condition that such resignation is tendered at an appropriate time. Otherwise, the resigned member is accountable to the corporation for damages, if any, following the resignation.³⁷⁵ Still,

³⁶⁹ In remuneration of the committee, the Law requires that the corporation be responsible to compensate its chairperson and remembers in proportion to several considerations, such their qualifications, the size of the corporations, the weight of their duties, and the duration of their appointment. *See* Article 69.

³⁷⁰ Article 68 (3).

³⁷¹ Article 68 (3).

³⁷² Article 68 (3).

³⁷³ Article 68 (3).

³⁷⁴ Still, the Law does not define what may constitute improper cause or inappropriate time. *See* Article 68 (3).

³⁷⁵ Article 68 (3).

“an appropriate time” is somewhat ambiguous. Unless it is defined by implementing regulations, the term is left to the judiciary to construe.³⁷⁶

B. The Chairperson of the Board

The importance of the corporation’s chairperson stems from the fact that chairpersons are the statutory representatives of the corporations before courts, arbitration tribunals, and other third parties.³⁷⁷ Therefore, the Law vividly defines some of their roles in the corporations and entrusts them with a range of duties and responsibilities to supervise the corporations’ operations and sail their corporations toward their objectives.

To ensure their integrity and to prevent any conflict of interests in playing their supervisory roles, the Law (and for the first time) mandates the separation between the position of chairperson and any other executive posts (e.g., CEO, CFO or GM).³⁷⁸ The statutory prohibition of combining supervisory and executive roles emphasizes the importance to respect the parameters of each corporate institution, prevents mingling between them, and advances a strong corporate governance structure.³⁷⁹

The Law hardly touches upon the powers of the chairperson and rather refers to the corporation’s articles of association for the powers and responsibilities with which the chairperson is entrusted. In other words, at their discretion, shareholders set the boundaries of the chairperson’s powers needed to perform the duties and responsibilities of which the chairperson is in charge. Such responsibilities are calling for board meetings, ensuring adequate flow of accurate

³⁷⁶ The role of the judiciary in the protection of minority shareholders is demystified later in the research.

³⁷⁷ Article 82 (1).

³⁷⁸ Article 81 (1).

³⁷⁹ Almajid, at 256 (The importance of splitting these posts stems from the heavy burdens each post gives rise to. Therefore, separation between these positions is approved to be an effective approach for corporations seeking better performance, effective monitoring, and more accountability to both corporate insiders and outsiders.)

information to the board's members to discharge their duties properly, ensuring the existence of actual communication channels with shareholders, preparing meetings' agenda, creating a culture that encourages constructive criticism, and informing shareholders of any conflict of interest a member of the board has, directly or indirectly.³⁸⁰

C. Meetings of the Board

To ensure the minimum level of the board's profession and proper performance of its duties, the Law obliges the board to convene at very least twice a year.³⁸¹ These statutory meetings are called for by the board's chairperson.³⁸² In addition, the Law obligates the chairperson to call for a board meeting whenever it is deemed urgent or upon the request of two of the board's members.³⁸³

Again, this is the bare minimum set by the Law, which means that shareholders may require more than two meetings a year. For example, they may stipulate in the corporation's bylaws that the board hold quarterly meetings, or specify incidents upon which the chairperson is to call for a board meeting.³⁸⁴

Moreover, to ensure collaborative work and reject any unilateral one, the Law requires a quorum of at least half of the board's members, in all cases not less than three members, for the

³⁸⁰ These duties are duties of the chairperson of public corporations set forth in the Corporate Governance Regulation, Article 27. Nevertheless, they may serve as guidelines and examples for shareholders of close corporations in determining the powers of the chairpersons of their corporations.

³⁸¹ Article 83 (1).

³⁸² Article 83 (1).

³⁸³ Any stipulation against this rule (calling for a board meeting upon a request of two member) is deemed void. *See* Article 83 (1).

³⁸⁴ The Law, in exception to in-person board meetings, allows the board to make decisions by circulation for urgent matters that involve prompt attention of the board, provided that no member request in writing that the board convenes for deliberations. Any decision is made according to this exception has to presented in the first following meeting of the board. *See* Article 85.

validity of the board meetings. This means that if the board consists of only three members,³⁸⁵ all three members must attend the meeting to be deemed valid.³⁸⁶

Furthermore, given the sensitivity of the board deliberations and confidentiality of some corporate matters, the Law prohibits members of the board from delegating others to attend board meetings on their behalf. Instead, they may assign only another board member with the proviso that the corporation's bylaws permit such assignment.³⁸⁷

In principle, board decisions are passed by majority vote of the attending members. In case of ties, the meeting chairperson has the casting vote. However, the Law gives shareholders some latitude to require a different passage rate or set another rule governing the board's ties.³⁸⁸

Deliberations of the board meetings and its decisions are required to be maintained and recorded in minutes. They must be signed by the chairperson,³⁸⁹ attending members, and the secretary. Also, all board's minutes must be kept in a special record that is signed by the chairperson and the secretary of the board.³⁹⁰

D. Powers of the Board

The board of directors well embodies the mind of the corporation. It enjoys a great deal of latitude and authorities to discharge its duties and responsibilities to manage, supervise, monitor and protect the corporation and its core business. Therefore, The Law affirms wide-ranging

³⁸⁵ The Law allows the articles of association to require higher percentage or numbers, not less than three in all cases. *See* Article 83 (2).

³⁸⁶ On the contrary, a number of jurisdictions, including Italy, France, Germany, and the U.K. and U.S., permits one-person board or so-called single general director, particularly for small and private corporations. *See* REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 12 n.44 (Oxford Univ. Press 3rd. ed. 2017).

³⁸⁷ Article 83 (3).

³⁸⁸ Article 83 (4).

³⁸⁹ The chairperson is to preside board's meetings. In the absence of the chairperson, the vice-chairperson is to head the meeting. Article 82 (2).

³⁹⁰ Article 85.

authorities to the board in steering the corporation and achieving its ends. Unless the corporate matter is entrusted to the shareholder general assembly,³⁹¹ the corporation's board has the absolute power to decide such a matter and skillfully execute all activities within the corporation's scope.³⁹²

An example of the board's powers is the creation of the executive office to run and monitor day-to-day operations. The board may assign to this branch one or more of its members or may hire an outsider.³⁹³ In all cases, chairpersons of the boards may not combine between their posts and any other executive jobs.³⁹⁴

Another power the Law assigns to the board of directors is the board's right to enter loan agreements. This power has no restrictions on the amount of these loan agreements. For example, the board may make a loan deal exceeding the corporation's capital. Therefore, the shareholders should be acutely aware of the ramifications of such a default power and make sure whether they want to leave it as the Law pronounces it, or place some restrictions on it by means of stipulation in the articles of association.

By the same token, the Law entrusts the board with the power to sell the corporation's assets. However, there are some restrictions the Minister of Commerce and Investment has issued to regulate this power in joint-stock corporations.³⁹⁵ The ministerial resolution requires the board to have the ordinary general assembly approve the sale of more than 50% of the corporate assets,

³⁹¹ Corporate matters entrusted to the shareholder general assembly find their origin either in the Law (e.g., appointment of the board members) or in the articles of association (e.g., sale of corporate assets). *See generally supra* Chapter 3. Part II.

³⁹² Article 75.

³⁹³ The Law does not mandate that a member of the board be assigned to any executive position. Practically speaking, assignment of at least one of the board directors to an executive post is of paramount importance because this "managing director" is the eye of the board upon its daily activities, and it guarantees skillful execution of the board's plans.

³⁹⁴ *See supra* Chapter 3. Part III. B.

³⁹⁵ *See supra* note **Error! Bookmark not defined..**

regardless of the sale's being through one or multiple transactions.³⁹⁶ If the corporation's bylaws require that the extraordinary general assembly approves such a sale, then the bylaws prevail, and such approval must be obtained accordingly.

In addition, the Law asserts for the board the power to remit the debt owed to the corporation. The board may decide to relieve corporate debtors from any liability vis-à-vis the corporation. This power is assigned to the board unless the corporation's bylaws opt out of it or restrict it.³⁹⁷

Above all, the Law empowers the board of directors with whatever is necessary to look after the corporation's management and the accomplishment of its aims. The shareholders should decide in the corporation's bylaws whether to leave these powers as they are, to restrict them, or to opt out of them, given that the corporation is always bound by the acts and transactions executed by the board even if these acts fall beyond the scope of the board's powers.³⁹⁸

E. Duties of the Board

The duty of care and the duty of loyalty are of the foremost duties owed by directors to the corporation and its shareholders. These duties set the parameters of the board's operations and conduct. According to the American Law Institute, the duty of care entails that directors are obligated to the corporation to discharge their duties and "act in good faith and in a manner the

³⁹⁶ If sales of corporate assets take place through multiple transactions, only the transaction that crosses the 50% threshold must be approved by the general assembly. This percentage is calculated from the date of first sale transaction occurred during the last 12 months.

³⁹⁷ Article 75 (2).

³⁹⁸ Holding the corporation accountable for the acts performed by the board in violation of their stipulated powers may be justified by the protection of a *bona fide* third part. Otherwise, the corporation is not responsible for the board's actions executed with a third party who acts in bad faith or knows that the board exceeds its powers in executing such actions. *See* Article 77.

directors reasonably believe to be in the best interest of the corporation.”³⁹⁹ On the other hand, the loyalty duty requires directors to place the interest of the corporation ahead of their interests.⁴⁰⁰

Given the locked-in structure of the close corporations and the popularity of majority shareholder’s directing the corporation’s affairs, a respectable counterargument, on the other hand, may doubt the efficacy of imposing the duty of loyalty and duty of care upon controlling shareholders in their capacity as directors in such a situation. Instead, the advocate of this argument assumes that holding a controlling shareholding is per se enough to generate “financial incentives” to render “well-informed decisions.”⁴⁰¹

The Saudi Law does not embrace these corporate standards in determining the scope of the board’s duties. Instead, it sets forth a matrix of obligations and prohibitions that all together convert these all-encompassing duties of corporate boards into laws and regulations. For example, the Law explicitly sets forth stringent statutory approaches to handle a wide range of party-related transactions of which a member of the board may straddle both sides.⁴⁰² In prevention of the conflict of interests, the Law requires that the ordinary general assembly must approve potential transactions and contracts in which a director of the board may have a direct or indirect interest. If this director happens to be also a shareholder, the Law requires the interested director to refrain from casting a vote on the transaction under scrutiny. The Law places a duty of disclosure upon

³⁹⁹ American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations*, Part IV (1994)

⁴⁰⁰ MICHAEL A. CHASALOW, *EXPERIENCING BUSINESS ORGANIZATIONS* 418 (WEST ACAD. PUB. 2014).

⁴⁰¹ Jens Dammann, *The Controlling Shareholder's General Duty of Care: A Dogma that Should Be Abandoned*, 2015 U. ILL. L. REV. 479, 506 (2015) (The argument differentiates between non-shareholder directors and controlling-shareholder directors, where the latter invest largely in the corporation they control. One of the main reasons advanced to reject enforcement of duty of care upon controlling-shareholders directors is that their financial incentives differ from the incentives of independent directors. Owners are best at advancing the interests of the corporation, and thus their interests without the need of duty of care to protect the interest of minority shareholders. As evidence, no Delaware court has ever found a controlling-shareholder director accountable for the violation of care duty.)

⁴⁰² See *infra* note 637 for the definition of related-party transactions.

any director with a conflict of interest to disclose to the board any interest, direct or indirect, he or she has in the corporation's transactions and contracts. Such disclosure includes a definition of the interest's nature and what financial or in-kind benefits if any, he or she may obtain.⁴⁰³ Also, the disclosure is to be recorded, and the chairperson has a duty to inform the general assembly when it convenes to decide whether to approve these transactions and to provide a special report from the corporation's external auditor opining the questionable transaction.⁴⁰⁴ Failure to comply with the statutory disclosure provides legal grounds for not only the corporation but also any stakeholder to judicially request invalidation of the contract or transaction, or request disgorgement of the profits.⁴⁰⁵

In addition, a subset of the duty of loyalty the Law recognizes is the non-compete duty. The Law bans board directors from engaging in any activity that competes against the corporation's business or even competes with activity within the line of the corporation's business.⁴⁰⁶ The prohibition of competing seems to be sensible as directors serving two corporations tend to favor one over the other in terms of the time and information allocated to the corporations.⁴⁰⁷ However, directors may seek permission from the corporation (general assembly) to engage in any competitive business. Otherwise, the corporation may petition to the judiciary and seek

⁴⁰³ Ministerial Resolution, No. 32565, First.

⁴⁰⁴ Article 71 (1).

⁴⁰⁵ Article 71 (2).

⁴⁰⁶ Article 72.

⁴⁰⁷ REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 158,159 (Oxford Univ. Press 3rd. ed. 2017) (giving an example of Germany as a country that has non-compete rule barring top executives and directors in close corporations from competing against the corporation they serve).

compensatory damages for the harm caused to the corporation in violation of the non-compete duty.⁴⁰⁸

Another traditional prohibition on the party-related transaction is the prohibition of loans between the corporations and their directors. The Law stretches the prohibition to also include all corporate fiduciaries (directors, shareholders, officers).⁴⁰⁹ The prohibition of loans to corporate fiduciaries include also prohibiting the corporation from serving as the guarantor for loan agreements these fiduciaries have with third parties.⁴¹⁰ A Statutory exception to this prohibition is that loan and guarantees made by the corporation pursuant to the corporation's incentive programs are permissible on the condition that such programs are adopted in the corporation's bylaws, or by a resolution issued by the general assembly.⁴¹¹ Another statutory (and intuitive) exception are loan and guarantee agreements between banks and credit corporations (in the form of joint-stock corporation), on the one hand, and its fiduciaries (including shareholders, directors and executives), on the other, provided that such loans and guarantees fall within the corporations' purposes and are subject to the same provisions and conditions followed with other clients.⁴¹² Any

⁴⁰⁸ *Id.* (stating that allowing directors and executives to compete with their corporation may, on the other hand, have some advantages, such as attracting competent executives and “[benefiting] from the know-how gathered by . . . executives as directors of competitors in the same industry.”)

⁴⁰⁹ Article 73 (1).

⁴¹⁰ The prohibition of loans between the corporation and its directors is also known in France and the United States. In the latter, for example, the Congress forbade public corporations from making personal loans to their managers following several corporate scandals (e.g., Enron). *See* § 402 Sarbanes-Oxley Act. Another reason to forbid loans between the corporation and its fiduciaries is that managers use them “to leverage their ownership of company shares, thus increasing their incentives to engage in questionable practices aimed at bolstering the share price.” *See* REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 158,159 (Oxford Univ. Press 3rd. ed. 2017).

⁴¹¹ Article 73 (3).

⁴¹² Article 73 (2).

violation of this statutory prohibition or the provisions of its exceptions gives the prejudiced corporations the right to seek compensations for any damages the corporations sustain judicially.⁴¹³

Last but not least, the Law emphasizes the duty of the board's directors not to disclose any confidential information or corporate secrets they come to know by virtue of their directorships, except disclosure of information to the general assemblies.⁴¹⁴ This duty entails that they also refrain from misappropriating corporate information to gain personal benefit for themselves, their relatives or others. This may seem to be a blanket prohibition on all nonpublic corporate information. If a director gets caught in violation of this confidentiality duty, the Law penalizes the violated director with immediate removal from the board and accountability for any damages to the corporation because of such violation.⁴¹⁵

F. The Responsibility of the Board

1. vis-à-vis the corporation

a. Civil Liability

To ensure the board's performance and discharge of its duties pursuant to the book, the Law imposes joint liability upon the board of the corporation for damages and losses affecting the corporation or its shareholders. A range of scenarios give rise to joint liability upon the members

⁴¹³ Note that the Law does not give statutory standing for stakeholder to seek compensations, or request invalidation of such agreements. *See* Article 73 (4). In this context, one may wonder why the new Law has excluded the requirement that a director have to own some of the corporation's shares value to of 10,000 Saudi Riyals(\$2,666), which served as an alignment-incentive strategy that would tie the interests of the directors to the interests of shareholders. Plus, in cases of director's violating the Law and mismanaging the corporation, the corporation would claw back the shares of the errant director in case of the director's refusal to pay the penalties or damages. The required amount might have been low and have not generated enough incentives to serve the best interests of the corporations. Nevertheless, the alignment-incentive strategies (such as trusteeship strategy) have significant impacts on the board of directors. *See* Almajid, at 247; REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 35–36 (Oxford Univ. Press 3rd. ed. 2017).

⁴¹⁴ Article 74.

⁴¹⁵ Article 74.

of the board. Such cases are mismanagement of the corporation and failure to comply with the Law or the corporation's bylaws.⁴¹⁶ To elaborate, if the wrongdoing giving rise to the board's joint liability is a result of a unanimous decision by the board, all board' members are jointly liable for such an act. If the decision is by a vote of the board's majority, joint liability is only imposed upon members who have voted in favor of the wrongful decision. Dissenting members to the decision, however, is not liable provided that their candid objections are recorded in the board's minutes. If a member of the board is absent from the board meeting at which the decision is made, the absence in principle does not constitute proper cause for relief from the liability. Instead, the absentee has to show that she or he has no knowledge of the decision, or that the absentee is unable to object after becoming aware of the decision.⁴¹⁷

b. Criminal Liability

Alongside the civil liability, the directors of the board are also subject to criminal liability for a cluster of actions that per se constitute crimes (e.g., embezzlement, forgery), or offenses the Law criminalizes.⁴¹⁸ Article 211 and 212 of the Law sets forth a wide range of activities the Law considers as offenses, and thus puts the Bureau of Investigation and Public Prosecution in charge of these offenses. Such offenses are manipulation with the corporation's books and records (cooking the books), providing misleading information, abuse of powers to gain personal benefits, and failure to call for an extraordinary general assembly where is mandatory by the Law (e.g., losses exceeding 50% of the share capital). Some of these offenses are punished by up to five years of imprisonment and a monetary fine up to five million Saudi Riyals (\$1.3 Million) or either

⁴¹⁶ Article 78 (1)

⁴¹⁷ Explanation of shareholder derivatives and statute of limitations are provided later in this dissertation as statutory, protective mechanisms available for minority shareholders.

⁴¹⁸ V. S. Khanna, *Corporate Criminal Liability: What Purpose Does it Serve*, 109 HARV. L. REV. 1477, 1534 (1996) (comparing the pros and cons of criminal liability to other the upsides and downsides of other sorts of directorial liability, including civil one).

penalty.⁴¹⁹ Others are penalized by up to one-year imprisonment and a fine up to 1 million Saudi Riyals (\$ 266,666), or either penalty.⁴²⁰ In all cases, these penalties do not negate any other penalties in other legislation.

2. vis-à-vis Third Parties

As explained earlier,⁴²¹ the corporation bears the full liability for all acts and deeds of its board of directors even if these actions are taken in violation of the board's stipulated powers.⁴²² The only exception to relieve the corporation from such liability is that the third party behaves in bad faith or knows that the board is exceeding its assigned powers. In addition to the accountability of the corporation over its board actions, third parties or stakeholders (e.g., creditors) have the right to sue the members of the board under the tort law liability. Directors are agents, so they are liable for their tortious conduct, irrespective to the corporation's (the principal) vicarious liability. Also, the individual, in general, is liable for his wrongdoing. For example, the distribution of sham dividends.⁴²³ In this situation, the third party has the option to sue the corporation based on vicarious liability or tort law liability.⁴²⁴

G. Rewards and Remunerations of the Board

The boards' rewards and remunerations are the main tunnels through which some shareholders/directors in close corporations appropriate a large sum of the corporation's profits. Therefore, the Law has adopted strict remuneration policy that takes into consideration, on the one

⁴¹⁹ Article 211.

⁴²⁰ Article 212.

⁴²¹ See *supra* Part 3. III. D.

⁴²² Article 77.

⁴²³ AHMED ALKHABTI & HISHAM ALSSEBT, *الوجيز في أحكام الشركات في النظام السعودي الجديد* [THE COMPENDIUM OF CORPORATE RULES IN THE NEW SAUDI LAW] 208 (Dar AlEjadh 2017).

⁴²⁴ MICHAEL A. CHASALOW, *EXPERIENCING BUSINESS ORGANIZATIONS* 99 (WEST ACAD. PUB. 2014) (stating that "it is often fruitless to bring such a claim if the agent is judgment proof but the right exists nonetheless.")

hand, safeguarding the interests of the corporation and its shareholders', and on the other hand the responsibility and tasks undertaken by the board of directors.

The Law recognizes a cluster of remunerative pay and reward packages⁴²⁵: fixed salary, in-kind benefits (e.g., cars, telephones, housings, newspapers), bonuses, or in the form of meeting allowance. The Law in principle permits the combination of two or more of these forms, provided that the total of monetary and in-kind rewards received by each director is no more than the statutory maximum of 500,000 Saudi Riyals (\$ 133,333). In deciding the rewards and remunerations for the corporation's directors, the Law stipulates a number of guidelines every corporation should follow. Such guidelines are the following: the fair proportionality between the remuneration and the director's experience, powers, and duties; the size and the industry of the corporation; the creation of incentives to attract qualified, experienced people and maintain them; and the proportionality with the corporation's work and the skills needed to manage it. That implies that remuneration packages may vary from a director to another accordingly.

Since the ultimate job of the board is to maximize the value of the corporation for its shareholders, it is of importance to have a performance-based payment to incentivize directors to discharge their duties optimally. Such an incentive may be created by linking the remuneration of the director to a stipulated percentage of the corporation's profits. To do so, the Law requires three conditions. First, the percentage of profits the director is entitled to receive does not exceed 10% of the net profits of the corporation after deduction of the reserves stipulated in the corporation's bylaws or decided by a general assembly's resolution. Second, the corporation must distribute to

⁴²⁵ The Regulatory Rules and Procedures Relating to Unlisted Joint-Stock Corporations defines remunerations as to include "amounts, allowances, profits and their equivalent, periodic and annual performance-related bonuses, short and long term incentive plans, in addition to any other in-kind benefits, except for reasonable costs and expenses actually incurred by the Company on behalf of a Board member in performing his work."

its shareholders dividends constituting at least 5% of the corporate paid-in share capital. Third, the remuneration package of the director is to be proportionate with the number of meetings the director attended.⁴²⁶ In all cases, to preserve their independence, independent directors may not be compensated by a percentage of the corporation's profits or based directly or indirectly upon the corporation's profitability.⁴²⁷

Deciding the board's remunerations is of the authority of the ordinary shareholder general assemblies. The assembly decisions on remunerations may be based on recommendations by the remuneration committee (if the corporation has one similar to the compulsory committee for public corporations).⁴²⁸ In the assembly, nevertheless, members of the board who are shareholders as well are forbidden from casting their votes on the item of the board's remuneration during shareholder assemblies to prevent any conflict of interest.⁴²⁹ This being said, directors may obtain, besides their directorships' remunerations, additional rewards for any extra work they perform for the corporations. Such work includes participating in the audit committee,⁴³⁰ or undertakings of an executive, managerial, technical, or consultative task.⁴³¹

In reinforcement of transparency and strong disclosure system, the Law requires the board to report to the general assembly a detailed statement including all amounts (remuneration, expenses, and in-kind benefits) received by the board's directors during the corporation's fiscal year,

⁴²⁶ Article 76 (2).

⁴²⁷ See the Regulatory Rules and Procedures Relating Unlisted Joint-Stock Corporations, Article 3 (4).

⁴²⁸ Close corporations may follow the rules the Corporate Governance Regulations mandates public corporations follow in terms of establishing a remuneration committee that has at least one managing director and one independent director. The ordinary general assembly is to approve appointments to the committee, their durations and the committee's manual based on recommendation advanced by the board of directors. In addition, the Regulation requires the committee to convene at least once a year, and when a meeting is deemed necessary. Alongside the committee's task to propose recommendations to the assembly, it is also asked to constantly review the remuneration policy and its efficiency and propose changes, if any, to the board of directors. See Articles 60– 63 of the Corporate Governance Regulations.

⁴²⁹ See the Regulatory Rules and Procedures Relating Unlisted Joint-Stock Corporations, Article 3 (3).

⁴³⁰ See *supra* Part 3. II. B.

⁴³¹ See the Regulatory Rules and Procedures Relating Unlisted Joint-Stock Corporations, Article 4.

alongside what they received in another capacity (as employees, executives, or members of corporate committees. This annual report has to include also the number of the meetings the board held, and the number of meetings each director attended from the date of the last general assembly.⁴³²

If it is proved that directors have been paid erroneously because of the false and misleading information presented to the general assembly or the inclusion of such information in the board's annual report, the corporation may reclaim return of these payments.⁴³³ Also, when the board member is removed because of his absence from three consecutive board meetings without legitimate excuse, this member is not entitled to any payments starting from the date of the last meeting he or she attended and has to pay back whatever is received for that period.⁴³⁴

Part IV. External Auditing

The right to oversee the corporation is of the statutory rights the Law stipulates for shareholders to keep the corporate management in check regarding its adherence to the corporate governance of the corporation. Nevertheless, shareholders often lack the necessary knowledge and capability to supervise and keep an eye on the management's compliance with the rules. To tackle such an issue and prevent any self-dealing by the board at the expense of shareholders' interests, corporate laws emphasize the significance of the outside auditor as a gatekeeper of the corporation and protector of its good corporate governance.⁴³⁵

⁴³² Article 76 (4). In addition, it is emphasized in the Regulatory Rules and Procedures Relating Unlisted Joint-Stock Corporations in Article seven.

⁴³³ the Regulatory Rules and Procedures Relating Unlisted Joint-Stock Corporations, Article 6.

⁴³⁴ See Article 76 (5) of the Law; *and* the Regulatory Rules and Procedures Relating Unlisted Joint-Stock Corporations, Article 5.

⁴³⁵ The term "gatekeeper" generally refers to outside professionals who keep the corporation protect the corporation and its dealings with the public, and thus protect the interests of its shareholders and investors. See, e.g., John C. Jr. Coffee, *Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293, 1297 (2003) ("[G]atekeepers are independent professionals who are so positioned that, if they

As the Law has made it of its mission to promote the best corporate practices, the Law mandates joint-stock corporations (listed and unlisted) to have an external auditor (in addition to the internal audit committee explained earlier).⁴³⁶ The Law specifies in details the manner of the auditor's appointment, its qualifications, powers, tasks, and its liability. The procedural details ensure the strong application of the corporate governance principles in terms of accountability, integrity, and independence of the auditor as displayed hereunder.

A. Appointment

Since the right to monitor the corporation is of core shareholder rights,⁴³⁷ the Law puts the ordinary shareholder general assemblies in charge of appointing one or more auditor to their corporations.⁴³⁸ The decision of the appointment also includes their compensations and their periods.⁴³⁹ The Law specifies some requirements of the appointment of auditors: first, the auditor must be accredited to operate and render services in the region; second, the total period of the auditor's appointment must not exceed five consecutive years.⁴⁴⁰ In exception to this rule, the

withhold their consent, approval, or rating, the corporation may be unable to effect some transaction or to maintain some desired status."); Peter J. Henning, *The New Corporate Gatekeeper*, 62 WAYNE L. REV. 29, 29 (2016) ("The term 'gatekeeper' is used with some regularity these days to describe the roles of various professionals who work to keep corporations from running afoul of the law in their dealings with the public, thereby helping to avoid harm to investors and the markets."); Sung Hui Kim, *Gatekeepers Inside Out*, 21 GEO. J. LEGAL ETHICS 411, 413 (2008) (defining gatekeepers as "private intermediaries who can prevent harm to the securities markets by disrupting the misconduct of their client representatives."). These definitions of gatekeepers concur with the role of these professionals to fend off any corporate misconduct or wrongdoing.

⁴³⁶ See *supra* Chapter 3. Part II. B.

⁴³⁷ Article 132 reads that "[s]hareholders shall monitor the company's accounts in accordance with the provisions set forth in the Law and the company's articles of association.")

⁴³⁸ Article 133 (1).

⁴³⁹ Article 133 (1).

⁴⁴⁰ Article 133 (1).

corporation may re-appoint the auditor, who has depleted the five-consecutive-year period, after the elapse of two years from the expiration date of the five-year period.⁴⁴¹

In addition to these restrictions upon the appointment's duration, the Law outlaws the appointments of the auditors who have participated in the incorporation process, served on the board, or executed administrative or technical tasks for the corporation's sake.⁴⁴² The Law goes farther as it also requires that auditors may not be partners with, nor employees or relatives of, one of the founding shareholders or the board's members.⁴⁴³ Evidently, the Law aims at ensuring auditors' integrity and independence in discharging their duties and avoiding any collision with the corporation's internal institutions.

As the shareholder assemblies have the right to appoint the auditor, they also have the right to replace it at any time,⁴⁴⁴ with or without cause. However, this does not negate the right of the auditor to seek judicial compensations for unjustified replacement or inappropriate replacement timing.⁴⁴⁵

B. Powers

To properly execute their jobs, the Law assigns several powers to outside auditors that allow them to access books and records of the corporations at any time. In case of ambiguities in these books and records, they have a statutory power to demand the board's clarification of whatever falls within their scope of work, such as the verification of the corporation's assets and liabilities.⁴⁴⁶

⁴⁴¹ To illustrate, if a corporation appoints X as an auditor for five-year term ending in October 31, 2020, this auditor will not continue to serve as an auditor for the corporation after this date, and may be re-appointed as an auditor only after October 31, 2022.

⁴⁴² Article 133 (2).

⁴⁴³ Article 133 (1).

⁴⁴⁴ "It" in this context refers to the auditor as the Law allows to appoint as both natural and legal persons.

⁴⁴⁵ Article 133 (1).

⁴⁴⁶ Article 134.

The Law commissions the chairperson of the board with facilitating the work of the auditor and paving the way for it to perform its statutory duties. Any obstruction or hindering of the auditor's duties, the auditor is to report to the board, and if such obstruction continues or the board does not react, the auditor is obliged to request an ordinary shareholder general assembly meeting to discuss such matter.⁴⁴⁷

C. Duties

To protect the interests of the shareholders and stakeholders, auditors have a duty to annually report to shareholders as a class (general assembly). The report includes the corporation's status, the board's position as the auditor is performing its duties (whether the board has been cooperative or not), and any violation of the Law or the corporation's bylaws the auditor detects as a result of auditing.⁴⁴⁸ The report also includes the auditor's opinion upon the integrity of the corporation's financial statements. The report has to comply with the auditing standards as it reflects the corporation's assets and liabilities. In addition, the auditor is required to read the report to the shareholders at the general assembly to have their approval of the report. Otherwise, the Law sanctions the approval of the report without reading it with the annulment of the approval, which stresses out the importance of ensuring the awareness of shareholders of the corporation's status on all levels.⁴⁴⁹

Another duty upon the auditors is the duty of confidentiality. Since corporate auditors are empowered to access corporate books and records, the Law bars them from disclosing any information or corporate secrets of which they have become aware as a result of performing their duties and exercising their powers. The duty even includes the prevention of discourse of

⁴⁴⁷ See *supra* note 300.

⁴⁴⁸ Article 135.

⁴⁴⁹ Article 135.

information to shareholders of the corporation unless disclosure is part of performing auditors' duties (e.g., reading the report at the general assembly).⁴⁵⁰

D. Accountability

To ensure the high-level performance of duties, the Law holds auditors accountable for any damages the corporation sustains because of a wrongful act committed by the auditors. Their accountability is not only vis-à-vis the corporation and shareholder but also to third parties.⁴⁵¹ In case there is more than one auditor, the Law imposes joint liability upon all auditors for such damages. In addition, Failure to comply with their duties may also result in mandatory removal of the injuring auditor and compensations to the corporation for damages, if any (e.g., disclosure of a corporate secret).⁴⁵²

Moreover, to deter auditors from abusing their powers and to prevent them from engaging in any self-dealing activities, the Law penalizes auditors who violate their duties by, for instance, reporting misleading information or false statements to shareholders with a fine up to five million Saudi Riyals and imprisonment up to five years, or either penalties.⁴⁵³ Ensuring proper functioning of auditors requires strict rules regarding the liability of their work and prevent any action that may compromise their integrity and independence.

Closing Analysis

Having depicted the regulatory framework of joint-stock corporations and their internal and external institutions, an observer may affirmatively conclude that the Saudi Companies Law of 2015 has assumed a very rigorous approach— in dealing with joint-stock corporations— that

⁴⁵⁰ Article 136 (1).

⁴⁵¹ Article 136 (2).

⁴⁵² Article 136 (2).

⁴⁵³ Article 211 (A).

heavily leans toward shareholder-centric corporate governance, alongside the inherent nature of shareholder supremacy in a close corporation structure. Several grounds may justify the shareholder-centric tendency in the Law. First, as mentioned in the previous chapter, the controlling shareholders abound in the region. The government— which is unitary absolute monarchy— is the largest shareholder in the Saudi market. Therefore, it seems to be logic for the government, and controlling shareholders dominating the market to retain the powers and influence over the management. This is candidly found in the Law in its empowering of the shareholder general assemblies with a wide range of decision and appointment rights, such as the decision to appoint and remove directors and auditors, the decision to distribute dividends, the decision to approve of a related-party transaction, and the decision to approve the corporation's annual financial reports. This approach may be useful in mitigating the shareholder-manager agency problem, especially in public corporations. However, one may be skeptical about its efficacy to offer adequate incentives for the management team to properly run the corporation without shareholders' watching over their shoulders.

Moreover, as far as the regulatory framework of close corporations concerns, it is evident the excessive use of mandatory rules and procedures in regulating corporate affairs. From the incorporation phase, incorporators find themselves in a pool of rules and procedures that systemically regulate every aspect of incorporation, deviating the contractual view of the corporation, albeit the statutory definition of the corporation. For instance, a statutory minimum of share capital must be met; special qualifications of shareholders have to exist; protracted, cumbersome filing and notarization procedures must be undergone.⁴⁵⁴ This may be justified as it

⁴⁵⁴ Conversely, the World Bank Group reports that— based on comparing business regulation for domestic firms in 190 economies— Saudi Arabia has simplified registration process (publication, notarization, and inspection). The Reports claims that Saudi Arabia has made it easier to start a business

protects incorporators themselves and third parties to the corporation, yet it does not mesh with rationale behind lowering the statutory capital requirement to 500,000 Saudi Riyals(\$133,333), which is alleged to serve as an incentive to conduct businesses in the form of close corporations (the incubators of future public corporations). Such an incentive should be coupled with simple, inexpensive incorporation procedures. It may be true that the old statutory minimum of capital share requirement (2 million Saudi Riyals) may have prevented some businesses in be in the form of joint-stock corporations; however, lowering the share capital requirement should be accompanied by simplicity of incorporation that would drive more businesses to select this corporate form, as a practical matter.

In addition, the Law adopts a cluster of mechanisms to alleviate agency problems between controlling shareholders and non-controlling shareholders. Such statutory mechanisms come in the form of disclosure requirements, reporting system, decision rights, and other “legal strategies”⁴⁵⁵ that all together aim at reducing the costs of information and coordination among corporate players, namely the majority and the minority shareholders in the context of close corporations. Otherwise, the high costs of shareholder information and coordination would aggravate the situation. Therefore, from the very start of the business, the Law sets forth either mandatory rules or default rules for most of corporate affairs; some of these rules empower shareholders as a class, while other rules restrict the management, such as mandatory discourse of a “potential” conflict of

by an online system. *See* The World Bank, *Doing Business 2018: Reforming to Create Jobs*, Table 3A.1, (15ed. Oct. 2017).

⁴⁵⁵ A “legal strategy” is a term utilized by the authors of *Anatomy of Corporate Law: A Comparative Functional Approach* to indicate “a generic method of deploying the law instrumentally in a functional way.” It may come in the form of a default rule, mandatory rule, or a set of different rules. *See* REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* p.39, n.49 (Oxford Univ. Press 3rd. ed. 2017).

interest and self-dealing,⁴⁵⁶ or systemic reporting to shareholders, and mandatory meetings. The rigid regulations of substantive aspects of the relationship between minority shareholders and the management (represented by majority shareholders) ex ante afford a great deal of protection for the minority shareholders as it ensures the flow of information. Also, it affords protection for the outsiders as they will presume that a set of mandatory rules bind the corporation they are contracting with, and failure to follow them entails very severe consequences, including nullity of the action, monetary fines, or imprisonment.

However, by the exercise of imagination and employment of logic, the excess of mandatory rules and absence of standards, which would provide leeway not only for the relationship between the minority and the majority shareholders but also for an external authority to intervene, have led to some loopholes and counterproductive results the regulator may fail to notice. One example is the regulation of party-related transactions. The Law sets forth a bunch of mandatory rules (including disclosure and direct reporting to the board and the shareholders as a class), yet it may be a source of concern that the Law has indirectly empowered the minority with a veto right. The hypothesis drawn from this criticism is that there is a close corporation with two shareholders, the minority and the majority. The majority in its management capacity finds that the corporation needs to transact with another corporation where the same majority has some interest, a crisp example of a conflict of interest regulated by the Law. According to the Law, the board would have to report this deal to the general assembly to decide whether to authorize this deal. In this situation, the minority shareholder solely would have the right to make such a decision since the majority may not cast any vote. Of course, to decide such an issue, the Law requires the external

⁴⁵⁶ It is worth noting that the World Bank Group report of 2017 finds that Saudi Arabia has scored 7 points out of 10 in the conflict of interest regulation index. By comparison, this is higher than the regional average, 4.9 points, and the average of OECD high-income economies, which is 6.4 points. *See* The World Bank, *Doing Business 2018: Reforming to Create Jobs* (15ed. Oct. 2017).

auditor to submit and recite its opinion about this transaction, yet it is not compulsory to comply with its opinion. Rather, this requirement is to help shareholders to make an informed decision. This concern is that the minority shareholder arbitrarily declines to approve of such a transaction despite its fairness to the corporation and the favorable opinion from the external auditor. As a majority, one may find himself trapped in a corporation where its minority is paradoxically controlling. Even as an attorney of the majority, it is ambiguous whether such arbitrary refusal would constitute a cause of action that could be challenged in a court of law, given the absence of fairness constraint on the exercise of this right and the indeterminacy of the fairness standard.⁴⁵⁷

A standard-based regulation of the party-related transactions may be more capable of preventing such a problem, capturing different self-dealings not recognized by a rule-based regulation, and affording discretion for the judiciary to decide *ex post* whether a violation of duties has occurred. A counter argument may be raised as standard-based regulations require strong, active judiciary that immerses itself in assessing and shaping corporate affairs. Such a judiciary has yet to develop.⁴⁵⁸ Therefore, as long as the judiciary plays limited roles in shaping the corporate arena, rule-based regulations will dominate, yet thorough attention should be paid to their drafting to avert any loophole that cannot be filled, even by contract.

Another point that merits serious attention is the statutory maximum and minimum of the numbers of directors a corporate board has to embrace. One may argue in favor of the statutory cap as it, as mentioned earlier, prevents exploitation and misuse of the corporate fortune by over-appointing members to the board of directors and thus exhausting its earnings in the form of

⁴⁵⁷ By analogy, the situation may be applicable to the rights of the holders of preferred shares, whom the Law requires their approval to modify the rights of or issue new preferred shares. In the absence of a fairness standard, these holders may prevent the corporation from further financing the corporation. *See Supra* Chapter 3. Part I. B. 2.

⁴⁵⁸ The commercial judiciary system, its roles, and the remedies it offers are discussed in a later chapter as part of the enforcement mechanisms available to minority shareholders.

salaries and rewards for the board's members. This may be true given the unavailability of standard-based regulation. Nevertheless, the statutory minimum of three directors poses a seeming paradox in the regulatory framework of close corporations. Imposing this rule upon public corporations may be justified due to their massive capitals and projects that cannot be managed by one director. Nevertheless, compliance with this rule from a close corporation's point of view may force the corporation to incur additional expenses in the form of remunerations for the board's members, which would be distributed to shareholders in the form of dividends or redirected to the corporation capital for developmental purposes. The Law has lowered the statutory capital share requirement to make the form of the joint-stock corporation available to startups and small businesses that may be better off being run by a single director, as a matter of efficiency and function. As a minority shareholder, one prefers a multiple-member board that ensures— with cumulative voting— the minority voice in the boardroom, and thus finds this rule to be protective. However, there are other devices to raise the minority's voice in the boardroom without having unnecessary directors and paying for expensive compliance.⁴⁵⁹

Speaking of the board of directors under the Law, one may raise some concern about the mandatory rules for the board rewards and compensations. The Law offers a range of plans from which corporations select to structure their directorial pay packages— in light of the statutory proportionality standard.⁴⁶⁰ Also, the Law gives the right to decide the board's pay packages to shareholders only who are not members of the board. From a minority shareholder's point of view, this accounts for a great deal of protection as it prevents any opportunism and misappropriation of

⁴⁵⁹ Further explanation about this argument is provided in the next chapter in the context of minority shareholder's right for representation.

⁴⁶⁰ The Law requires that managerial compensations be proportional to the work done by the board. This requirement represents a standard that leaves room to decide not only for shareholders as a class but also for the external authority to intervene for enforcement or adjudicative purposes.

the corporate wealth. To ensure adherence and reduce the cost of supervising and monitoring, the Law imposes a disclosure requirement, as a valid legal strategy, on the board to submit to the shareholder body a report containing what members of the board have received. Unlike other corporate statutes that come to regulate how corporations remunerate their directors, the Saudi Law, however, goes above and beyond to stipulate—by means of compulsory rules— how much a corporation can compensate its board of directors. Theoretically, this may be worrisome as it disheartens the board to properly execute their ultimate duty of maximizing the wealth and advancing the interests of the corporation, and thus its shareholders—including the minority. The size of the corporation is different, so it seems absurd to impose a one-rule-fits-all cap on the boards' remunerations of titanic corporations with thousands of shareholders (e.g., corporations of the petroleum and petrochemical industry) and medium or small close corporations with a handful of shareholders. In both sorts of corporations, boards will be disinclined to thrive in doing their unless they receive encouraging—or at least adequate— payments proportional to the jobs with which they are entrusted. Otherwise, the corporation' performance and prosperity would be proportional to the compensations offered to the board.⁴⁶¹ Another argument about the efficacy of this statutory cap (as it is allegedly protective of corporation's wealth by preventing exportation) is that it does not encompass the remunerative mechanisms for executive officers, whom the board has the right to appoint, supervise, and compensate. Therefore, a controlling shareholder may appoint himself to an executive post, and —by a power of the board's majority— arrange expensive pay package for his post.

⁴⁶¹ E.g., Nithya Narayanan, *Activist Nominee Compensation: Balancing the Hedgehog's Dilemma*, 41 DEL. J. CORP. L. 345, 373 (2017) (criticizing the use of capping in remunerative mechanisms as a distinctive).

After all, the legislation does recognize the indispensable function of the board as the wheel of the corporation when it broadens its powers over corporate matters and holds the corporation liable, in principle, for all board's actions vis-à-vis third parties. To prevent any abuse of such power, the Law, on the other hand, reinforces the board's accountability to shareholders as a class and holds its members personally responsible for any corporate malfeasance or mismanagement of the corporation. The principle of accountability is of the foremost corporate governance principles that have been embedded in the Law in different forms and buttressed by several shareholder rights and strong external enforcement devices, including the criminalization of some directorial mismanagement and harsh punishments *ex post*.⁴⁶² Broader jurisdiction for the board over the corporation goes hand in hand with well-defined accountability rules for its actions, particularly in an environment where the judiciary seems unequipped to evaluate highly corporate affairs yet.

Another dimension to this analytical discussion of the Law is the maximum and minimum percentages for shareholder meetings' quorums and decision-passing. The Law differentiates between shareholder assemblies as it entrusts them with different tasks based upon their criticality to the corporation. Of course, the higher the required quorum and decision-making percentages are the greater the role played by the minority shareholders in shaping and deciding on the corporation's affairs, as an exercise of logic. Consequently, the Law requires the approval of 75% of the share capital represented in a quorate extraordinary shareholder meeting for several

⁴⁶² However, some concerns may arise as that "too-zealous imposition of personal liability on managers might induce them to behave in a risk-averse fashion," adversely affecting the interests of shareholders on the long-term. REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 71 (Oxford Univ. Press 3rd. ed. 2017). *See also* Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857, 900 (1984) ("The legal risks of the firm's individual participants grow more onerous as we expand the scope of absolute personal liability and the range of participants at risk.")

instances (e.g., dissolution of the corporation, and increase or decrease of the share capital), which influences the existence of the corporation and the value of its shares.

As far as the statutory protection for the minority shareholder concerns, it is worth reminding that the dilemma of minority shareholders is a subset of a greater agency problem.⁴⁶³ To reduce the cost of the problem, the Law requires mandatory disclosure and makes of it a duty upon various corporate fiduciaries, including the chairperson, interested director, auditor, and the board as a whole. Again, the obligations of periodical and ad hoc disclosure foster the corporate transparency and generate a constant flow of information to not only the shareholders as a class but also to the third parties, which helps make informed decisions and assess corporate fiduciaries' performance.⁴⁶⁴ Another statutory instance with the goal to reduce the cost of information and coordination is the permission for the corporations to conduct their shareholder meeting via modern technology, which reduces the costs the shareholder may have to incur to exert his rights otherwise. The disclosure requirements translate into strong corporate governance of the corporation, on the one hand, and help outsiders (the market) to become informative of the corporation and thus to accurately assess the corporation.

So far, this chapter finds that the Law asserts several statutory rights for shareholders, and — in the protection of these rights— outlaws any alteration or contractual waiver of these rights whatsoever. At the top of these rights is the non-negotiable right to attend shareholder assemblies, irrespective to the percentage of shareholding. A shareholder of either one share or thousands of shares is statutorily entitled to attend shareholder's meetings and vote on the corporate matters.

⁴⁶³ See REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 71 (Oxford Univ. Press 3rd. ed. 2017) (asserting that mandatory disclosure is not a legal strategy itself; rather it “plays in the functioning of all legal strategies. . . .” [e.g., in directors' compensations in the Saudi Law]).

⁴⁶⁴ *Id.* at 72.

This gives rise to another statutory right of appointing directors to and dismissing them from the corporate board. That is an influential instrument in the hand of shareholders as a class that logically meshes with the ownership rights, given that shareholders are the owners of the corporation and only their interests are at stake. The Law's recognition of shareholder's right to attend and vote in a shareholder assembly coupled with the right to appoint and remove directors safeguards minority's rights in close corporations where their voice would be lowered, if not muted, otherwise.

Because of the unsophistication that dominates most close corporations, the auditing rules examined in this chapter appear to be a primary source of efficacy for the corporation. The Law mandates two sources for corporate auditing, internal and external. Both represent the structure of the shareholder's monitoring and supervision rights in close corporations. They are of the foremost tools employed to keep shareholders as a class in the loop about the corporate matters, assist them to make well-versed decisions, ensure corporate fiduciaries' compliance with the Law alongside corporate bylaws, and detect corporate malfeasance if any. For the monitoring and supervising structure to fructify, the Law sets forth rigorous rules governing the powers and tasks of both the audit committee and external auditor and holding them to a high standard of accountability for their wrongdoing if any.

All in all, one may conclude that the Law has translated a range of corporate governance principles into straightforward rules and procedures that encompass most of the corporate affairs, including a vivid governance structure, the board structure (appointment, removal, duties, powers, and remunerations), and auditing rules. On the book, those jointly accumulate for the advancement of corporate transparency, disclosure, openness, and accountability. However, whether these rules could attain these goals with efficiency and smoothness—not with unduly burden and high costs—

is an empirical question that may remain unanswered for a while due to the newness of the Law, and such spotted loopholes have not scratched the surface yet.

Chapter Four: The Statutory Protection of Minority Shareholder in the Law †

“The law is the only sure protection of the weak, and the only efficient restraint upon the strong.”

Millard Fillmore

Motivating Hypothetical

Now the business is incorporated in the form of a close corporation. Saad and his brother, Khalid, possess 25% each of the corporate capital. Their father owns 50% of the corporate capital. The three of them are deeply involved in the corporation’s day-to-day operations. They are also members of the board of directors. Saad reads the news that Saudi Arabia has introduced radical reforms that improve the protection of minority investors. Saad is wondering how the Law protects his interests, and whether he has a say in the management of the corporation.

The Scope of Chapter Four

This Chapter represents a case study of the minority shareholder protection in Saudi Arabia. It is divided into five sections. The first part introduces the reader to the minority shareholders’ issues in Saudi Arabia, and the factors affected the change in the policy of protecting their interests, leading to an indispensable role of law in the region. The second part offers an analysis of statutory shareholder rights. The third part demonstrates—through analytical reading—how the Law is an effective device to curtail oppressive conduct, and how it handles minority shareholders’ issues, including the minority’s directorial representation, the dilution of interests, and the unmarketability of shares. The fourth part underscores the role of formalism in the Law in one section, and it highlights some issues and limitations associated with this statutory approach in the other section.

Part I. Introduction

A. Overview

Due to the universal structure of the corporation, minority shareholders in Saudi Arabia, presumably like their counterparts in other parts of the world, suffer from inherent issues to which the close corporation structure gives rise.⁴⁶⁵ In short, the minority shareholders often have expectations while they are making investments, but these expectations are not necessarily met. That makes these disappointed shareholders want to exit the entity, yet the fact that disposing of their shareholdings for fair value—with no escape through the market—is relatively problematic and makes them stuck in an awkward position, as displayed earlier in chapter one.

Saudi Arabia has recently carried out a range of significant reforms to enhance business environments and captivate foreign investments. That requires the modernization of the regulatory framework governing the business domain, and the reinforcement and the protection of businesspeople and entrepreneurs' rights. To this end, one of the primary steps the country has taken is the enactment of the Saudi Companies Law of 2015.⁴⁶⁶

To this point, the Law has earned an excellent reputation for its strong protection for investors. According to the World Bank Group Report of 2017, the region ranks the 10th globally in protecting minority investors, whereas it was reported 36th in the 2016 Report.⁴⁶⁷ Moreover, the Report highlights the existence of a strong conflict of interest regulation, which exceeds the regional average.⁴⁶⁸ All together symbolizes the governmental determination to move forward and

† Hereinafter “the Law” refers to the Saudi Companies Law of 2015, unless otherwise noted.

⁴⁶⁵ See *supra* Chapter 1. Part II.

⁴⁶⁶ See *supra* Chapter 2. Part I. A (4).

⁴⁶⁷ See The World Bank, *Doing Business 2018: Reforming to Create Jobs*, Country Tables, p. 190 (15ed. Oct. 2017).

⁴⁶⁸ *Id.*

ensure a business climate for entities of all sizes. Nevertheless, a question arises, how has Saudi Arabia set this unprecedented record in such a short period? And why?

To begin with, unlike the orthodox method utilized in protecting minority shareholders and curbing opportunistic and oppressive conduct of majority, the Saudi legislature has taken an unconventional approach in addressing the issues of minority shareholders and protecting their interests. In the United States, for instance, oppression of minority shareholders in close corporations are squarely handled by the judicial intervention *ex post*, which has created judicially established principles (e.g., heightened duty on controlling shareholders, partner-like duty, mandatory buyouts, and the judicial consideration of the minority's reasonable expectations) in deciding oppression claims brought by minority shareholders.⁴⁶⁹ The judicial protection comes as a result of the minority shareholders' failure to contract against oppression and opportunism by the controlling shareholders. In this sense, corporate laws play a gap-filling role, leaving the governance rules of the corporation to shareholders to decide how they want to manage and run their businesses (contractarian view).⁴⁷⁰

A number of writings on the minority's issues in the United States advocate for, and rely on heavily, the judicial intervention to curb opportunism and oppression by controlling shareholders. This appears to mesh well with the contractarian view of the corporations besides an effective judicial system that is sophisticated to execute its functions of applying fairness and resolving shareholder squabbles. The same can be said about minority shareholder dilemma in Saudi Arabia except for the part of the effective judiciary that would rectify the situation *ex post*.

The commonplace failure of shareholders to bargain for their protection alongside the limited role of the Saudi judiciary led Saudi lawmakers to intervene and take a different route in protecting

⁴⁶⁹ See *supra* Chapter 1. Part III. B.

⁴⁷⁰ See *supra* Chapter 1. Part III. C.

minority investors, including close corporations' shareholders. The newness of the Saudi approach is represented by an assortment of prescriptive rules that shareholders must adhere to in governing their business, setting a benchmark for effective corporate governance for the corporations in the region. The general theme of these rules is centered around empowering shareholders as a class with agenda-setting supremacy.⁴⁷¹

This core chapter seeks to convince the reader that the statutory protection for minority shareholders—through a set of compulsory corporate governance rules—is an effective approach to blocking the way ahead of controlling shareholders from engaging in any abusive or opportunistic conduct toward the minority at the first place. The unsophistication of both the judiciary and shareholders of close corporations in the region necessitates the governmental intervention to eliminate, or at least minimize, the issues generated by the locked-in structure of the close corporations, such as illiquidity of shares, selective repurchase of shares, dilution of interests, and management expectations.

Another dimension of this chapter is to contribute to the ongoing debate over the minority shareholder of close corporations by putting forward a proposal for a statutory approach in protecting minority shareholders that may be followed by countries with similar circumstances as Saudi Arabia's. The prevalence of family businesses that are run by blinded trust among their members makes it difficult for these members, in reality, to bargain for themselves or at least expect conflicts and tensions in the future when it looks rosy at the outset. Furthermore, the developing corporate judiciary poses a threat that its rulings may not be anticipated ahead of time, and thus foreign investors appear to be reluctant to rely on such an approach in facilitating shareholders' private ordering, or in construing their agreed-on provisions. Because of these

⁴⁷¹ See The World Bank, *Doing Business 2018: Reforming to Create Jobs*, p. 29 (15ed. Oct. 2017).

circumstances, a corporate law with governance rules—that protect minority shareholders, balance the power, and ensure the exercise of rights⁴⁷²—is of necessity as explained hereunder in reinforcing investor’s trust and offering a healthier business environment.

B. The Role of Law in the Region

The importance of corporate law’s role in the Saudi business environment stems from four overlapping factors. First of all, Saudi Arabia is an Islamic state that is mostly influenced by the civil law system.⁴⁷³ Hence, Laws and regulations are the primary sources for the legislation, especially for the business sector.⁴⁷⁴ Therefore, the necessity of the new law is unquestionable to chase the rapid changes the country has been pursuing.

Second, in developed countries (e.g., the U.S. and the U.K.), corporate laws are not only statutes that legislatures promulgate. Instead, they also include other players of social, judicial, and legal aspects.⁴⁷⁵ In fact, some scholars claim that corporate laws themselves perform a “trivial” role.⁴⁷⁶ On the other hand, corporate laws in emerging markets and economies are the linchpin of

⁴⁷² See *infra* Chapter 4. Part II.

⁴⁷³ For an in-depth explanation about the legal system of Saudi Arabia and the role of Sharia in shaping it, see Faisal M. Al-Fadhel, *Legislative Drafting and Law-Making Practices and Procedures under Saudi Arabian Law: A Brief Overview*, 1 I.J.L.D.L.R. 95 (2012); Abdullah F. Ansary, *A Brief Overview of the Saudi Arabian Legal System*, GLOBALEX (2008)

http://www.nyulawglobal.org/globalex/Saudi_Arabia.html; George N. Sfeir, *The Saudi Approach to Law Reform*, 36 AM. J. COMP. L. 729 (1988); FRANK E. VOGEL, *ISLAMIC LAW AND LEGAL SYSTEM: STUDIES OF SAUDI ARABIA*, BRILL (2000); FAHAD M. ALMAJID, *A CONCEPTUAL LEGAL FRAMEWORK FOR REFORMING SAUDI CORPORATE GOVERNANCE*, ch.4 Lambert Academic Publishing (2014). [hereinafter: AlMajid]

⁴⁷⁴ See FAHAD M. ALMAJID, *A CONCEPTUAL LEGAL FRAMEWORK FOR REFORMING SAUDI CORPORATE GOVERNANCE*, pp.140 Lambert Academic Publishing (2014) (referring the special recognition for regulating the business sector and incorporating modern legal concepts to the establishment of the country in 1932. It “intensified...when large oil fields were discovered in the Eastern province.”)

⁴⁷⁵ See Bernard S. Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1914 (1996) (claiming that corporate law in developed countries includes “other legal, market, and cultural constraints on the actions of corporate managers and controlling shareholders to achieve a sensible balance among . . . competing needs.”)

⁴⁷⁶ See Bernard S. Black, *Is Corporate Law Trivial: A Political and Economic Analysis*, 84 NW. U. L. REV. 542 (1990).

the business and the only wheel that rotates the market. Their contribution to the businesses in these countries outweighs the value added by corporate statutes in developed countries clearly because of the weak role played by other institutions⁴⁷⁷ that shape the corporate behaviors in the developed ones.⁴⁷⁸

Third, corporate laws in developed countries coexist with other supporting legal institutions. As stated above, the U.S. state courts represent the cornerstone in the protection for minority shareholders by for instance defining oppression and imposing a partner-like duty on dominant shareholders.⁴⁷⁹ However, this is not always the case in Saudi Arabia or other developing countries, where the judiciary works and develops sluggishly.⁴⁸⁰

Not only do rules and regulations aim at protecting the interests of minority shareholders—when they neglect or fail to bargain for their protection—, but also they serve an essential role in protecting the interests of outsiders.⁴⁸¹ Outsiders include creditors of the corporation, its workforce, and its bondholders. An example of such an immutable rule is that corporations must maintain a statutory reserve of 30% of the advanced corporate capital.⁴⁸²

⁴⁷⁷ *Id.* at 1913, (defining “the term “institution” in a broad sense to include private organizational structures such as stock trading systems and securities registrars; public organizational structures such as securities regulators, courts with experience in commercial matters, an honest police force, and a reliable mail system; and mixed public private structures such as self-regulatory organizations, an accounting profession, and sophisticated financial accounting rules.”)

⁴⁷⁸ *Id.*

⁴⁷⁹ *Id.*

⁴⁸⁰ Classifying Saudi Arabia as a developing country is still debatable. AlMajid argues that Saudi Arabia should be considered as a developed country, particularly in terms of wealth. He believes that his discussion can serve as supportive evidence for such a claim. *See* FAHAD M. ALMAJID, A CONCEPTUAL LEGAL FRAMEWORK FOR REFORMING SAUDI CORPORATE GOVERNANCE, footnote 76 Lambert Academic Publishing (2014); *but see* RODNEY WILSON & OTHERS, ECONOMIC DEVELOPMENT IN SAUDI ARABIA, pp.6 RoutledgeCurzon (2004) (asserting that Saudi Arabia is a developing country).

⁴⁸¹ *See generally* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 237 (Harv. Univ. Press 1991) (ascribing the importance role played by rules and regulation in protecting third parties to the fact that “. . . voluntary contracting is not feasible.”)

⁴⁸² The Law obliges joint-stock corporations to build a statutory reserve. In doing so, corporations must put 10% of its net profits by every year, and they may cease putting aside the 10% portion upon two

Another example is the approval requirement of a special assembly consisting of bondholders concerning any change in their entitlements in addition to the approval of the shareholder general assembly.⁴⁸³ Such mandatory rules reinforce the third party's confidence in dealing with corporations in the region, which accumulate for the public good of the market as a whole.⁴⁸⁴

These four points heighten the significance to put together, *inter alia*, a corporate act that fulfills the needs of the country, especially with the declaration of the Kingdom's 2030 Vision. In short, the 2030 Vision reflects, *inter alia*, a steadfast commitment to end the era of oil dependency. Instead, it aims at rehabilitating the business ambiance to attract foreign investments, and empower small and medium-sized enterprises.⁴⁸⁵ Such a goal requires the existence of strong corporate governance embedded in an effective corporate law.⁴⁸⁶ All in all, knowing that Saudi Arabia is one of the emerging markets, it is of prominence to comprehend the role played by laws in such a country that lacks sophisticated institutions that would otherwise contribute to shaping the protective system of minority shareholders.

Part II. Statutory Shareholder Rights

The Law incorporates a set of statutory rights that shareholders enjoy so long as they hold to their shares. These rights differ in their importance, yet they all together, the research argues,

conditions: first, the statutory reserve has reached 30% of the corporation's paid-in share capital; second, the corporation's ordinary general assembly votes in favor of discontinuing setting aside 10% of its net profits for the reserve. *See* Article 129 (1).

⁴⁸³ Article 166 (2).

⁴⁸⁴ As mentioned earlier, close corporations have a vital role not only in the Saudi economy—due massive size of their capitals,—but also in the labor market as they are the employers of circa 80% of workforce in the private sector. *See supra* Chapter 2. Part II. B (2).

⁴⁸⁵ For an in-depth look at the Saudi 2030 Vision, including its themes, goals, and challenges, see <http://vision2030.gov.sa/en>

⁴⁸⁶ *See* Bernard S. Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1914 (1996) (claiming that even if the issues that a corporate law endeavors to redress are worldwide, it is of importance for the corporate law to be context-specific).

establish strong protection for and a great deal of deference to the minority shareholders. This result flows from—and is premised upon—the statutory view of the shareholder. In principle, shareholders in close corporations are co-owners who enjoy equal rights and impartial treatment under the Law. There may be, nevertheless, some exceptions to the general rule, such as preferred shares, yet the Law sets forth a number of rights to ensure that the minimum impartiality is upheld.

To begin with, a “statutory” right under the Law implicates two significant results: First, the right may not be eliminated or limited by any means of a contract, agreement, or an opt-out provision, and such an arrangement is deemed void and null under the Law.⁴⁸⁷ Second, the shareholder enjoys the right by force of law, without the need to be stipulated in any of the corporation’s constitutional documents (i.e., articles of associations and corporate bylaws) and irrespective to the size of his shareholding (one share or million shares).⁴⁸⁸ These results are of paramount importance for shareholders, mainly minority ones, as they prevent the controlling shareholders from, by means of bargaining power, denying the minority of any rights explained hereunder. In addition, it reduces the cost of contracting the minority shareholder may incur as these rights are guaranteed by law, and thus even if the minority shareholder is an unsophisticated businessperson, he has these rights in any case.

The shareholder’s statutory rights can be categorized by subject into two collections: economic rights (e.g., right to receive dividends, right to sell shares, and right to residual claim upon liquidation) and control rights (e.g., right to vote, right to elect directors, right to supervise the corporation, right to inspect the corporation, and right to call for a shareholder meeting).

⁴⁸⁷ See Article 110, which read that “[s]hares shall entail equal rights and obligations. Shareholders shall have all rights associated with shares, particularly the rights to dividends. . . .” and Article 88, which constrains the powers of the extraordinary shareholder assembly as it may not deprive a shareholder of his fundamental rights, including “obtaining a share of distributed dividends. . . .”

⁴⁸⁸ *Id.*

Shareholders advance capitals with the expectation that they in return obtain some financial benefits and run the corporation—or at least have a say in the corporate management. Therefore, the Law embraces a set of fundamental rights that assert the shareholder supremacy in the corporation.

Note that, for the sake of clarity and given the importance of several rights, the research examines these rights under different rubrics as they are useful tools to eliminate and minimize the minority shareholder's issues. These rights include the right to elect directors and the right to file derivative or direct action.

A. Economic Rights

1. The Right to Receive Dividends

One of the fundamental rights the share confers on its holder is the right to receive dividends. As a matter of law, it is one of the main elements of the statutory definition of the corporation, the share of profits and losses.⁴⁸⁹ No shareholder shall be denied receiving returns on his investment.⁴⁹⁰ Returns may be in pecuniary form, in the form of bonus shares, or both. Moreover, an important aspect of this right is that only shareholders—through their assemblies—have the power to declare dividends.⁴⁹¹ The board of directors may make some suggestion or propose a distribution plan,⁴⁹² but the shareholder assembly always retains the ultimate say by means of a shareholder resolution.

⁴⁸⁹ Article two.

⁴⁹⁰ Article 88, 1 (a).

⁴⁹¹ By comparison, the board of directors in the United States reserves the right to declare dividends or not, yet such a power is limited by judicial review, or so-called the business judgment rule. *See* 11 WILLIAM MEADE FLETCHER ET AL., CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5320, at 562—63 & nn.7-8 (perm. ed., rev. vol. 2003), *and* Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 414 (2006).

⁴⁹² Article 175, (“The company’s directors shall prepare . . . proposals on distribution of dividends within three months from the end of the fiscal year.”)

Therefore, given the limitation placed on the board's remunerations,⁴⁹³ the controlling shareholder has a strong incentive not to vote against the declaration of dividends, and thus all shareholders receive some of the corporation's net profits after it satisfies its statutory obligations, such setting aside the statutory reserve.⁴⁹⁴ Unless the shareholder possesses preferred shares—which may not have a voting right⁴⁹⁵—, all shares yield the same percentage of returns regardless of the position of their holders, controlling or minority shareholders.⁴⁹⁶ Nevertheless, the Law does not obligate the corporation to distribute dividends in a timely manner, yearly or quarterly.⁴⁹⁷ Instead, shareholders may stipulate it in the corporation's bylaws, or leave it to the shareholder assembly to decide.⁴⁹⁸ Placing the discretion to declare dividends within the shareholder assembly makes this right of paramount importance in protecting minority shareholders, rather than it is being so “illusory” and of little significance had it been within the will of the board of directors.⁴⁹⁹

Another constraint—that ensures the distribution of dividends and not to be obstructed by controlling shareholders—is tying the directorial remuneration in the form of profits to the declaration of dividends to shareholders.⁵⁰⁰ To illustrate, the Law grants the corporation freedom

⁴⁹³ See *supra* Chapter 3. Part III. G.

⁴⁹⁴ Article 131.

⁴⁹⁵ Article 114.

⁴⁹⁶ Article 110.

⁴⁹⁷ See Article 37 of the RRP (listing a number of requirements with which corporations have to comply whenever they consider a distribution of dividends, including regular positive profitability, reasonable liquidity, and possible foreseeing of the scale of the corporations' profits).

⁴⁹⁸ Article 131.

⁴⁹⁹ In the United States, for instance, shareholders have the “right” to receive dividends, yet only the board of directors has the right to declare dividends, which renders shareholders' right illusory and trivial. See Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 424 (2006) (prioritizing shareholder rights in the United States and dividing them into illusory or ancillary rights, on one the hand, and fundamental rights, on the other).

⁵⁰⁰ Article 76 (2).

to select how it compensates its directors.⁵⁰¹ Nevertheless, if the corporation wants to tie its directors' compensation to their performance and thus to the corporation's profitability, the Law requires, *inter alia*, that the corporation distribute dividends—representing at least 5% of the corporation's paid-in capital—to shareholders.⁵⁰² Evidently, such a requirement deprives the controlling shareholder of appropriating the corporation's profits to themselves only. In sum, if the controlling director/shareholder wants a slice of the pie, so do other shareholders. Thus, he has to share the pie with them.

2. The Right of Residual Claim on the corporation's Assets upon Liquidation

Another basic, yet significant right to which the shareholder is entitled is the right to claim his share in the remaining of the corporation's assets after liquidation. Only after the corporation enters into liquidation and all of its creditors are paid, shareholders can have a claim against the outstanding assets if any.⁵⁰³ As in the right to receive dividends, this right is protected in multiple positions within the Law as it cannot be contracted out or denied, for it is of the statutory, inseparable rights the share accords to its holder.⁵⁰⁴

B. Control Rights

1. The Right to Vote

Voting right is the shareholder's mechanism to exert power over the corporation's management, given the separation between ownership and management in today corporation.

⁵⁰¹ Article 76 (1).

⁵⁰² Article 76 (2).

⁵⁰³ Article 110 reads that “[s]hares shall entail equal rights and obligations. Shareholders shall have all rights associated with shares, particularly the rights to dividends, the company's assets upon liquidation . . .”

⁵⁰⁴ Article 88 (1) (A) (II) constrains the powers of the extraordinary shareholder assembly as it may not deprive a shareholder of his fundamental rights, including “obtaining a share of the company's assets upon liquidation”

Therefore, the Law, similar to other corporate laws, confirms the voting right for shareholders to decide corporate matters.⁵⁰⁵ However, the extent of this right over corporate affairs differs from law to another based on whom the law empowers the most: shareholders or directors.

The CL vests a great deal of power in shareholders as a whole by requiring their votes to approve a broad range of corporate affairs. Such affairs are the director's compensation,⁵⁰⁶ mergers,⁵⁰⁷ increase or decrease in the corporate capital,⁵⁰⁸ bylaws amendments, issuance of shares,⁵⁰⁹ and appointment and removal of directors.⁵¹⁰ Such a right exemplifies the shareholder's control over not only shareholder affairs (e.g., restrictions on share sale) but also managerial affairs (e.g., issuance of share and approval of related-party transactions).

2. The Right to Attend the Shareholder Assembly

It may seem to be intuitive that the right to vote implies the right to attend; otherwise, where else would shareholders cast their votes? However, the access to shareholder meetings was denied to shareholders with tiny shareholdings—less than 20 shares under the superseded law.⁵¹¹

As it is demonstrated in the previous chapter, the shareholder assembly as a powerful organ is the mainstay of a number of rights the Law asserts for shareholders. It is the regulatory instrument by which shareholders, for instance, elect (or oust) directors,⁵¹² declare dividends,⁵¹³ amend

⁵⁰⁵ Article 110 reads that “[s]hares shall entail equal rights and obligations. Shareholders shall have all rights associated with shares, particularly . . . voting on resolutions”

⁵⁰⁶ See *supra* Chapter 3. Part III. G.

⁵⁰⁷ Article 64 (4) (requiring an extraordinary shareholder assembly with 75% of the shares represented in the assembly in favor of the merger to approve of such a transaction).

⁵⁰⁸ Articles 137 & 138.

⁵⁰⁹ Articles 137 & 138.

⁵¹⁰ See *supra* Chapter 3. Part III. A (1) & (2).

⁵¹¹ Article 83 of the Companies Law of 1388H.

⁵¹² See *supra* Chapter 3. Part III. A (1) & (2).

⁵¹³ See *supra* Chapter 4. Part II. A (1); Article 129 (2).

corporate bylaws,⁵¹⁴ approve of a related-party transaction,⁵¹⁵ decide managerial remunerations,⁵¹⁶ and so on. To ensure that shareholders exert their statutory powers, the Law guarantees the right to attend for all shareholders—irrespective to the size of their shareholdings.⁵¹⁷ A change signifies the legislature’s intention to reinforce the minority shareholder’s participation in corporate matters, and also it signals the impartiality of the Law toward all shareholders.

To make the shareholder’s attendance effective (rather than illusory) and substantive (rather than procedural), this right entails a couple of ancillary rights that enhance the role of the shareholder during corporate assemblies. Any shareholder—or his representative⁵¹⁸—has the right to discuss any corporate matters listed in the meeting agenda and also has the right to direct questions (about these matters) to directors of the board or the external auditor.⁵¹⁹ Both of which are of great importance in reducing information and coordination costs for shareholders to be well-informed and thus efficiently exercise their rights.

The Law penalizes the violation of these rights in two ways. First, the Law imposes a monetary fine up to 500 thousand Saudi Riyals (\$133,333) on anyone who intentionally denies or deprives a shareholder of his right to attend a shareholder assembly or cast his vote.⁵²⁰ Second, the harmed shareholder is entitled to submit an order to the assembly to nullify any resolution issued in

⁵¹⁴ Article 88.

⁵¹⁵ *See supra* Chapter 3. Part III. E.

⁵¹⁶ *See supra* Chapter 3. Part III. G.

⁵¹⁷ Article 86 (2) reads that “[e]ach shareholder shall have the right to attend meetings of shareholder general assembly, even if the company’s articles of association stipulates otherwise. . . .”

⁵¹⁸ Shareholders have the right to attend themselves, or delegate this right to their representatives—except directors of the board and the corporation’s employees—to attend on their behalf. *See* Article 86 (2) (stipulating shareholder’s right to delegate his right to attend and vote to other person) *and* Articles 44 to 47 of the RRP (detailing the implementing rules for the exercise of this right).

⁵¹⁹ Article 96.

⁵²⁰ Article 213 (F).

violation of his rights—even if in his absence due to an acceptable excuse.⁵²¹ Although it is unclear what constitutes an “acceptable excuse”, it indicates that the shareholder’s presence is encouraged, protected, and treated with great deference, however.

3. The Right to Request Shareholder Meeting

Knowing that a number of shareholder’s rights are exercised through only the shareholder assembly, the Law has asserted that shareholders (as well as members of the board and auditors) have the right to request the board to call for a shareholder assembly. Such a request has to be submitted by a shareholder or a number of them in possession of at least 5% of the corporate capital.⁵²² The board of directors has no discretion but to carry out the request.⁵²³

The board’s failure to respond to shareholder’s request permits shareholders with only 2% of the corporation’s shares to submit the request to the Ministry of Commerce and Investment to hold a shareholder meeting within 30 days from the request date.⁵²⁴ Such a procedure emboldens the minority shareholders to raise their voice about any corporate matter that would not be enclosed in a prepared-by-board agenda.

4. The Right to Monitor and Supervise the Corporation

This informational right allows any shareholder to access and observe corporate books and records.⁵²⁵ Unlike other laws,⁵²⁶ this right is of great significance as it is absolute. To clarify, the

⁵²¹ Article 178 (1). However, the Law stipulates statute of limitation of one year from the date of the prejudiced decision. *See* Article 178 (2).

⁵²² Article 90 (1) stipulates that “[t]he board of directors shall call for an ordinary general assembly meeting if so requested by . . . a number of shareholders representing at least 5% of the capital.”

⁵²³ *Id.*

⁵²⁴ Article 90 (3).

⁵²⁵ Article 88 (1, a, v) prohibits any amendment to the shareholder’s right to access the corporation’s books and documents.

⁵²⁶ For example, Shareholders in some U.S. states bear the burden that they have a proper purpose to review “some” corporate documents. In other words, it is the board’s call whether to allow shareholders to access corporate information. *See, e.g.,* Security First Corp. v. U.S. Die Casting & Dev. Co., 687 A.2d 563, 568 (Del.1997).

Law does not mandate shareholders to prove a legitimate purpose to exercise this right. The board has no statutory ground to refuse the shareholder's access to look at the board's minutes, the corporation's financial records, or other documents. Such a denier (e.g., the controlling shareholder or a member of the board of directors) is subject to a monetary penalty.⁵²⁷ In addition, the judiciary has ruled in multiple cases in favor of letting shareholders access and review not only primary documents (e.g., bylaws and board's minutes) but also financial records and assessment.⁵²⁸

There may be, nevertheless, some concern about the minority shareholder's abusing this right to harm the corporation, or expose it to potential damage, yet the Law stays silent about any restrictions imposed on this right. By employment of logic and exercise of imagination, it may be proposed that this right be subject to the same limitations imposed on the director's answering shareholder's questions. In principle, the Law obligates directors to answer the shareholder's question to the extent that the answer does not sabotage the corporation's interests.⁵²⁹ In case the shareholder is dissatisfied with the director's response, the Law sets a mechanism to settle such a conflict. The displeased shareholder may then petition to the assembly, which adjudicates whether the answer at dispute is inadequate.⁵³⁰

5. The Right to Judicial Inspection

The right to judicial inspection offers minority shareholders the chance to have an outside player reviewing and assessing some corporate matters. For example, shareholders may have their suspicion about some directorial misbehavior taking place within the corporation or that the

⁵²⁷ See *infra* Chapter Five, Part II.

⁵²⁸ Article 213 (J) states that "[w]ithout prejudice to any harsher penalty stipulated in any other law, a fine not exceeding 500,000 riyals [\$133,333] shall apply to: (J) any person who fails to give shareholders or partners access to necessary documents in accordance with the provisions of the Law. . . ."

⁵²⁹ Article 96 states that "[t]he board of directors or the auditor shall answer shareholders' questions to the extent that does not jeopardize the company. If the shareholder deems that the response to a question is unsatisfactory, he may appeal to the general assembly whose decision shall be final."

⁵³⁰ *Id.*

auditor has engaged in malpractice. For this reason, the Law grants the shareholders—who hold at least 5% of the corporation’s outstanding shares—the right to request the judiciary to order inspection of the corporation.⁵³¹

In terms of procedures, the inspection shall be approved only after the court has heard the defendant’s response.⁵³² In addition, to ensure that inspection requests are justified and with some merit, such inspection is entirely at the expense of the complaining shareholders so that shareholders will not submit a groundless, or abusive request.⁵³³ If the request turns out to be valid, the court has a basket of options it may select from: it may call for a shareholder meeting, and it may remove the directors of the board or the corporate auditor and appoint temporary directors whose powers and terms are also defined by the court.⁵³⁴

Part III. Minority Shareholder’s Issues in Light of the Law

This part explores how some prescriptive rules of the Law address the major issues confronted by minority shareholders in close corporations. It also argues that strengthening corporate laws can eliminate—or mitigate—the issues associated with minority status in close corporations. A strong corporate law can enhance the minority shareholder’s role in management, form a framework of continuous, compulsory disclosure about the business’s affairs, and ensure the integrity and professional judgment through the strict conflict of interest laws that uphold fairness and profitability for all shareholders.

This part continues to examine the Law’s response to the issue of shareholder’s expectation to run and manage the business through representation in the boardroom. It also casts light on the

⁵³¹ Article 100 (1).

⁵³² Article 100 (2).

⁵³³ *Id.*

⁵³⁴ Article 100 (3).

statutory treatment for the dilution of share value. Another issue this part addresses is the exit issue and how the Law protects the tradability of shares. In addition, it shows the Law's approach to curbing opportunistic conduct and conflict of interest transactions.

It is important to keep in mind that these rules are neither fully comprehensive nor perfect. They only empower minority shareholders with the necessary instruments to play their roles without fearing the cost of information and coordination and ensure them strong standing armed with a group of economic and control rights. If the shareholders seek more rights and powers, they should optimally bargain and contract for them. The following analyses of the Law are intended to be critical, rather than descriptive, and encapsulate the relevant rules and regulations that may be potent weapons in the hand of minority shareholders in their confrontation with close corporation's issues.

A. Enhancing Minority Shareholder's Representation on Corporate Board

Shareholders in close corporations oftentimes are a small number with interpersonal relationships and with expectations to manage the business.⁵³⁵ However, the expectations of minority shareholders may not be met unless they are secured by a provision in the corporate documents or by a long-term employment contract.⁵³⁶ Regardless of the rationale behind shareholders' failure to protect their expectations, the Law delivers reliable backup for these shareholders to play their statutory roles effectively and efficiently.

As the Law protects minority shareholders as the ultimate owners of the business through a set of economic and control rights, it also ensures that their stakes are represented (and not overlooked) in corporate boardrooms—proportionately to their interests' size. This lays in the shareholders'

⁵³⁵ See *supra* Chapter 1. Part II. C.

⁵³⁶ See *supra* Chapter 1. Part III. C.

ability to nominate one of them (or an outsider) to represent their interests on the board. To this end, the Law sets forth a couple of fundamental tools that ensure the representation of the minority's interests: the election of directors is a statutory right, and the cumulative voting is mandatory.

1. The Right to Elect Directors

One of the core rights of the shareholders is the right to elect their representatives to the board.⁵³⁷ This is a statutory right that may not be contracted out, waived, or denied.⁵³⁸ Moreover, it is argued that the shareholder's right to elect directors is of the foremost rights, and superior to other economic and control rights discussed earlier because of the powers this right confers on directors.⁵³⁹

In close corporations, however, shareholders oftentimes wear the hats of directors and managers; they elect themselves to the board of directors.⁵⁴⁰ Not all shareholders can wear such a hat, which makes the decision-making power resides in an individual or a small group of shareholders who possess a majority of the voting shares that suffice to elect the entire board.⁵⁴¹ Therefore, in solidification of the statutory right to elect directors and to ensure a greater chance of representation for the minority shareholders' interests on the board, the Law enjoins the

⁵³⁷ Article 68 (2) affirms that "[e]ach shareholder shall be entitled to nominate himself or one or more other persons for board membership, based on his share in the capital."

⁵³⁸ See *supra* Chapter 4. Part II.

⁵³⁹ See generally Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 409 (2006) (arguing that shareholder right to elect directors along with the right to sell are the most fundamental rights of shareholder).

⁵⁴⁰ See, e.g., John H. Matheson & R. Kevin Maler, *A Simple Statutory Solution to Minority Oppression in the Closely Held Business*, 91 MINN. L. REV. 657, 660 (2007) (differentiating between public corporations and close corporations based on the fact that minority shareholders often anticipate to occupy salaried positions, which constitutes de facto dividends).

⁵⁴¹ See ROBERT W. HAMILTON, CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES 435 (6th ed. 1998); Julian Javier Garza, *Rethinking Corporate Governance: The Role of Minority Shareholders - A Comparative Study*, 31 ST. MARY'S L.J. 613, 646 (2000).

observance of the cumulative voting in electing the board's members, thus eliminating the corporation's discretion to adopt such a rule.⁵⁴²

2. Cumulative Voting

The general principle is that shareholders have the discretion to design their voting system.⁵⁴³ In principle, shareholders vote on corporate matters—including the election of directors—by plurality voting. This voting system in the context of the director's election involves that every voting share is cast for each post on the board.⁵⁴⁴ Under such a system, the shareholder with a majority of the voting shares may select the entire board's members,⁵⁴⁵ which leaves the minority shareholders destitute of any chance to have their representatives on the board unless they have secured a voting agreement *ax ante*, or they voluntarily adopt the cumulative voting system.⁵⁴⁶

An exception to the general rule and in determination to reinforcing the minority shareholders' rights and raising their voice in the boardroom, the Law obligates joint-stock corporations—public and close—to adopting the cumulative voting in electing directors.⁵⁴⁷ The cumulative voting entails that the shareholder's voting shares are multiplied by the number of for-election posts on

⁵⁴² In the United States, for instance, cumulative voting is optional. Corporations have to stipulate such a method in their bylaws if they want to implement it in the election of directors. *See, e.g.*, Maddock v. Vorclone Corp. 147 A. 255, 255 (Del. Ch. 1929) (asserting that voting cumulatively is a special right that is mandated by statute, and thus it is prone to be amended, and incorporators have discretion whether to adopt such a voting manner); MODEL BUS. CORP. ACT § 7.28 (B) (2016) (“Shareholders do not have a right to cumulate their votes for directors unless the articles of incorporation so provide.”)

⁵⁴³ Article 95 states that “[t]he company's articles of association shall prescribe the manner of voting at shareholder assemblies.”

⁵⁴⁴ *See infra* note 548.

⁵⁴⁵ This voting approach is known as “straight voting” under the Model Business Corporation Act (MBCA), which is adopted by a group of U.S. states. *See also* JAMES D. COX ET AL., CORPORATIONS § 13.17, at 328 (1997) (describing straight voting as casting votes according to the number of shares held for each vacancy).

⁵⁴⁶ *See* 1 F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS ch. 3, § 3.17, at 37 (3d ed. 1998) (advising attorneys to stipulate cumulative voting for the election of directors in close corporations as a method to divide control power among all shareholders).

⁵⁴⁷ Article 95 excludes election of directors from the general rule (shareholder freedom to design the voting system). Instead, it mandates that “[c]umulative voting shall be used for electing the board of directors.”

the board, and the result is the product the shareholder may cast for a single candidate or divide among two or more candidates.⁵⁴⁸ Obligating corporations to assume the cumulative voting in electing directors accentuates the statutory role in promoting the minority's rights and its role in the governance of the corporation.

A significant effect the cumulative voting yields is that it enhances the chance of minority shareholders with considerable shareholdings (e.g., 10% or 20%) to have their interests represented and their voice heard as the board is vested with a great cluster of powers in formulating corporate policies and deciding corporate matters. It is worth bearing in mind that, however, the cumulative voting does not guarantee the minority's representation on the board, but rather it increases its opportunity to secure the board's representation depending on the size of the board. If the size of the board is large, the minority shareholders have a greater chance to elect one or more members to the board, and vice-versa.⁵⁴⁹ This meshes well with the statutory minimum of directors the corporation must have, preventing controlling shareholders from making the board small so that they would appoint all of the directors.

From a critical point of view, the Law mandates the cumulative voting in the appointment of directors, yet it stays silent whether the system must be followed in their removal. Assuming that this is a statutory loophole, directors will be therefore susceptible to removal by a plurality of

⁵⁴⁸ To clarify the difference between plurality voting and cumulative voting in the election of directors, assume that a corporation has two shareholders (X owns 50 shares, and Y and Z possess 20 shares each) and three vacant board seats. Under plurality voting, X can elect the entire board because X can cast his 50 votes for each seat. Under cumulative voting, shares are multiplied by the numbers of vacant seats. In this assumption, X has 150 votes (50×3), and Y and Z have 60 votes each (20×3). Candidate run at large rather than for specific seat. Therefore, candidates that receive the most votes get elected and become directors. X would be better off if it divides its votes between two seats because it can divide its votes among the three seats in a way that makes it win all seats, whereas Y and Z, the minority, should consolidate their votes to win one seat. *See also* MODEL BUS. CORP. ACT § 7.28 (c).

⁵⁴⁹ For example, assume corporation has two shareholders: X with 80 share, and Y 20 shares, and three vacant board seats. Even with cumulative voting, Y is unable to secure a seat on the board. If the there are five, however, the cumulative 80 votes of Y can secure it a seat on the board.

shares, eroding the usefulness of the cumulative voting for minority shareholders. To fill this gap, it may be suggested that the Law protects its cumulative voting and the appointment of minority shareholder's representative through a special requirement similar to the one stipulated in the MBCA. According to section 8.08, a resolution to remove the director may not be passed if a number of shares—enough to elect him by means of cumulative voting—are voted against such a resolution.⁵⁵⁰ By doing so, the Law would ensure that the controlling shareholder could not circumvent the minority shareholder's director of choice.

In sum, the shareholder's right to elect directors espoused by the mandatory cumulative voting manner in the appointment allows the minority shareholders to have access to the management of the corporation, represent their interests, stay informed about the corporate matters, engage in the formulation of corporate policy, and affect the governance of the corporation. It is an effective device to augment the minority's chance to participate in corporate management.

B. Protecting Share Value

The dilution of share value is another issue faced by minority shareholders.⁵⁵¹ During the lifespan of the corporation, the corporation may need to issue more shares for various reasons, such as raising capital in pursuit of a new business opportunity and conducting the first public offering. The issuance of new shares dilutes the voting power—and thus the value—of the shareholdings of the minority shareholders.

The prescriptive rules may serve as a protective device to ensure that the dilution of the minority's shareholdings is not driven by opportunistic nor oppressive motives, but rather it is the

⁵⁵⁰ See MODEL BUS. CORP. ACT § 8.08 (c) (2016) (“If cumulative voting is authorized, a director may not be removed if the number of votes sufficient to elect the director under cumulative voting is voted against removal.”)

⁵⁵¹ See *supra* Chapter 1. Part II. B.

result of a purely business decision. The statutory protection for the minority shareholder's share value flows from two main rubrics fished out from the Law: the approval requirements for share issuance, and the preemptive rights. Note that the following subsections do not divulge all of their procedural details, but rather they single out the significant rules that, I argue, constitute the statutory protection from the minority shareholder's standpoint.

1. Approval Requirement for Share Issuance

With respect to the shareholder primacy and the shareholder equality themes throughout the Law, the Law stipulates procedural mixture of protective rules that must be followed in case the corporation desires to increase its capital through the issuance of new shares.⁵⁵²

The first and foremost rule is that the decision to issue new shares is within the extraordinary shareholder assembly.⁵⁵³ Because the issuance of new shares entails an increase in the corporate capital and consequently a change in the corporation's articles of association, only the shareholders (via extraordinary assembly) may decide such a matter.⁵⁵⁴ Furthermore, the Law requires a higher resolution-passing percentage for the decision to, *inter alia*, issue new shares.⁵⁵⁵ In principle, resolutions pertaining one of the matters that fall within the jurisdiction of the extraordinary shareholder assembly (e.g., changing the corporation's name or engaging in a new business purpose) require the approval of at least a two-thirds of the voting shares represented in the

⁵⁵² Article 138 considers the issuance of new shares as the primary vehicle to increase the corporation capital, and it lists a number of options against which shares may be issued (e.g., cash, in-kind contributions, corporate reserve, company's debts, and debt instruments).

⁵⁵³ As Article 137 defines the extraordinary shareholder assembly as the competent authority to decide on the issuance of new shares with the proviso that the corporate capital has been paid in-full, except if shares are issued as a result of bondholders' right to convert their debt instruments into shares.

⁵⁵⁴ *See supra* Chapter 3. Part II. A. 2 (b).

⁵⁵⁵ *See supra* Chapter 3. Part II. A. 2 (b); Article 94 (4) (requiring a different resolution-passing percentage for the following corporate matters: increase or decrease of capital, extension of the corporation's lifespan, voluntary dissolution, and merger with another entity).

assembly.⁵⁵⁶ Nevertheless, a three-quarter majority of the voting shares represented in the assembly must approve of the decision to increase its capital—through the issuance of shares.⁵⁵⁷ By employment of logic and given that the validity of the assembly requires at least representation of 50% of the corporation capital,⁵⁵⁸ this resolution-passing percentage empowers the minority shareholders to have their say on such a decision, and prevent the controlling shareholders from exploiting the tool (issuance of share) to dilute their share value.

2. Preemptive Rights

Another protective aspect of the minority shareholders by the Law is the statutory recognition of the preemptive right for the existing shareholders.⁵⁵⁹ As a result of increasing corporate capital, shareholders enjoy the right to purchase new shares in proportional to their shareholdings.⁵⁶⁰ This right enables “registered” shareholders⁵⁶¹—including minority ones—to avert the dilution of their shares’ value and voting power in case the corporation increases its capital through the issuance of shares.⁵⁶²

⁵⁵⁶ See *supra* Chapter 3. Part II. A. 2 (b).

⁵⁵⁷ *Id.*

⁵⁵⁸ *Id.*

⁵⁵⁹ Preemptive rights may be, however, granted to non-shareholders provided that the extraordinary shareholder approves of such an arrangement. See Article 140.

⁵⁶⁰ Article 139 stipulates that “[a] shareholder shall . . . have a preemptive right to subscribe to new shares issued against cash contributions.”

⁵⁶¹ According to the RRP, registered shareholders are the ones who are registered in the shareholder registry at the end of the day on which the extraordinary shareholder assembly approves of a share capital increase, or at the end of the day specified by the ordinary shareholder assembly (or the board) on which shareholders become entitled to dividends. Moreover, the importance of knowing the status of registered shareholder intensifies as the Law mandates that changes to share’s ownership or its entitlements be marked in the shareholder registry. Otherwise, such a change (e.g., transfer of share’s ownership to another person) does not produce effect vis-à-vis the corporation. Article 162.

⁵⁶² See generally JAMES D. COX ET AL., CORPORATIONS § 16.14, at 475 (1997) (claiming that preemptive rights are an effective tool to prevent manipulation of voting control and dilution of share value); Julian Javier Garza, *Rethinking Corporate Governance: The Role of Minority Shareholders - A Comparative Study*, 31 ST. MARY’S L.J. 613, 620 (2000) (“This right is essential for minority shareholders, because without it, the majority could dilute both the holdings and the voting power of the minority.”); Lorenzo Segato, *A Comparative Analysis of Shareholder Protections in Italy and the United States: Parmalat as a Case Study*, 26 NW. J. INT’L L. & BUS. 373, 408 (2006) (suggesting that

Comparatively speaking, the Law’s treatment of this right, I believe, is unique. Unlike the United States where this right is purely contractual,⁵⁶³ the Law recognizes this right as a “quasi-statutory” right. Describing this right as a quasi-statutory right stems from the fact that it is a shareholder’s right by default, meaning that shareholders do not need to include an opt-in provision in the corporate documents to enjoy the right.⁵⁶⁴ On the other hand, this right may be subject in special circumstances to some limitations that preclude the shareholders from exercising the right.⁵⁶⁵ The statutory recognition of the preemptive rights weighs substantially in favor of protecting the minority shareholders, who (due to their fragile contractual position) may fail to bargain for and include the right in their corporate bylaws or the articles of association.⁵⁶⁶

Preemptive rights under the Law are not wholly statutory.⁵⁶⁷ The Law sets forth some circumstances under which this right may be suspended. For instance, the extraordinary shareholder assembly may suspend shareholders’ preemptive rights only if such suspension “deems beneficial for the company”.⁵⁶⁸ While it is ambiguous what constitutes a beneficial suspension, the statutory designation of this power to the extraordinary shareholder assembly represents protection that likely— by means of its representative quorum— brings about an informed and justified decision.

“[e]liminating preemptive rights significantly impairs the rights of minority shareholders [in close corporations] because it leaves them without economic protection and active participation in the business”).

⁵⁶³ See MODEL BUS. CORP. ACT § 6.30(a) (2016) (“The shareholders of a corporation do not have a preemptive right to acquire the corporation’s unissued shares except to the extent the articles of incorporation so provide.”); JAMES D. COX ET AL., CORPORATIONS § 16.14, at 475—76 (1997) (asserting that preemptive rights are not mandatory but permissive).

⁵⁶⁴ See *supra* note 560 and accompanying text.

⁵⁶⁵ See *infra* notes 568 & 569.

⁵⁶⁶ See *supra* Chapter 1. Part III. C.

⁵⁶⁷ See *supra* Chapter 4. Part II. for the definition of “statutory right”.

⁵⁶⁸ Article 140 states that “[t]he extraordinary general assembly shall . . . have the right to suspend shareholders’ preemptive rights to subscribe to the capital increase against cash contributions . . . in cases it deems beneficial for the company.”

Another limitation upon the exercise of the preemptive right is when the purpose of the share issuance is to distribute these shares to the workers of the corporation (or its subsidiaries).⁵⁶⁹ This constraint may apparently pose a threat that controlling shareholders issue new shares to themselves as employees of the corporation and thus deprive minority shareholders of their preemptive rights. Nevertheless, it is worth reminding that the power to issue new shares as a matter of law is within the extraordinary shareholder assembly,⁵⁷⁰ and the share issuance requires a high resolution-passing percentage,⁵⁷¹ which enhances the minority shareholder's chance to have a say in the matter.

Decisions in violation of the shareholder's preemptive rights are null and void.⁵⁷² For example, the issuance of shares without complying with the notification rule.⁵⁷³ Not to mention that the shareholders who prevent others from exercising their preemptive rights may be subject to monetary penalties, or even face criminal charges.⁵⁷⁴ In a word, the preemptive right is a powerful tool for the minority shareholders to maintain their power, preserve their share value, and probably prevent controlling shareholders from diminishing them.

C. Transferability of Share and Exit Option

A major issue inherited from the close corporation structure is the absence of a ready market.⁵⁷⁵ The frustrated or oppressed minority shareholders have no public market through which they may

⁵⁶⁹ Article 137 (2) confers the power to issue new shares to employees on the extraordinary shareholder assembly, yet shareholders' exercising preemptive rights is impermissible if such issuance of shares is allocated for the corporation's employees.

⁵⁷⁰ See *supra* Chapter 4. Part III. B (1).

⁵⁷¹ *Id.*

⁵⁷² Article 88, 1, a (vi).

⁵⁷³ Article 139 requires that shareholders be notified of such a right, and of the decision of capital increase along with the conditions and the period of subscription as well as beginning and ending dates, via publication in a daily newspaper, or transmission by registered mail.

⁵⁷⁴ See generally Articles 211—213.

⁵⁷⁵ See *supra* Chapter 1. Part II. A.

exit the corporation for fair value. Although the unmarketability of close-corporation shares is an integral part of the close corporation structure, several statutory steps help escape the adverse, likely consequences (e.g., freeze-outs). The steps include the statutory recognition of the share transferability (including the right to sell and the right to mortgage shares), the statutory limitations on the contractual restrictions of such a principle, and recently the mandatory offering rule.

1. The Statutory Principle of Share Transferability

One of the distinctive features of the joint-stock corporation the Law asserts is the tradability and transferability of its shares.⁵⁷⁶ This feature flows from the fact—and is premised upon the principle—that shareholders have property rights over their shares.⁵⁷⁷ Adjacent to the right to receive returns on their investments (as one of the property rights),⁵⁷⁸ shareholders are entitled to the statutorily-protected right to transfer their interests, which encompass both economic and control interests.⁵⁷⁹

a. The Right to Sell

The transferability of shares involves the shareholder's economic right to sell all or part of their shares or interests.⁵⁸⁰ Evidently, it is of the most important rights as it permits shareholders to liquidate their shares and consequently exit the corporation as well as making profits from

⁵⁷⁶ Article 88, 1, a (iv) (confirming that a shareholder's right to dispose of his shares is of the fundamental rights that shareholder assemblies have no power to exclude). Article 110, ("Shareholders shall have all rights associated with shares, particularly . . . disposal of shares")

⁵⁷⁷ Cf. MODEL BUS. CORP. ACT § 1.40 (22) (2016) (defining shares as "units into which the proprietary interests in a corporation are divided"); Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 414—15 (2006) ([S]hares are a form of personal property.)

⁵⁷⁸ See *supra* Chapter 4. Part II. A (1).

⁵⁷⁹ See *supra* Chapter 4. Part II. A & B.

⁵⁸⁰ See Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 414—15 (2006) (arguing that shareholder's right to sell is one of the most two significant rights shareholders enjoy, above other rights); Troy A. Paredes, *The Firm and the Nature of Control: Toward a Theory of Takeover Law*, 29 J. CORP. L. 103 (2003) (spotlighting the role of shareholder with the right to sell in the governance of the corporation).

selling parts of their interests,⁵⁸¹ such as selling their preemptive rights.⁵⁸² In principle, shareholders may dispose of their shares at will. It is the result of the separation between ownership and management in joint-stock corporations.⁵⁸³ However, this right—in the close corporation’s context—is oftentimes subject to a range of contractual restrictions discussed hereunder.⁵⁸⁴

b. The right to Mortgage

Another right that stems from the transferability feature and the conceptualization of share ownership as personal property⁵⁸⁵ is shareholders’ right to mortgage their shares. Again, the shares are part of the shareholder’s personal property, and thus the shareholder may pledge their shares,⁵⁸⁶ which lets creditors step into the shareholders’ shoes and exercise share-related rights—including the right to receive dividends.⁵⁸⁷ Nevertheless, such creditors may neither attend shareholder

⁵⁸¹ Cf. Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 425 (2006) (“This right of alienation [the right to sell] is of the utmost importance to shareholders both because it is a means of obtaining economic benefit from their investment in the corporation and because it is their means of exit should they become dissatisfied with management.”)

⁵⁸² *Accord* Article 141, (permitting shareholders to sell or reassign their own preemptive rights in the newly issued shares to others during the subscription period).

⁵⁸³ *But see* WILLIAM A. KLEIN & JOHN C. COFFEE, JR., *BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES* 132 (9th ed. 2004) (arguing that the feature of separation between ownership and management in close corporation’s context appears to be more theoretical than actual).

⁵⁸⁴ *Id.* at 109, (considering the absence of potential buyers as an implicit restriction upon transferability of shares in close corporations).

⁵⁸⁵ *See supra* note 577 and accompanying text.

⁵⁸⁶ Article 112 (2) (“Shares may be pledged in accordance with rules set by the Competent Authority.”) The Regulatory Rules and Procedures issued pursuant to the Companies Law relating to Unlisted Joint Stock Companies sets forth, in Part five, the governing rules of pledge of shares by shareholders, which is different from the rules stipulated in Part 4, Chapter 3 regulating the pledge of shares by the corporation. The most important rule, besides executing a mortgage contract, is that in order for share mortgage goes into effect vis-à-vis the corporation and third parties, share pledge has to be submitted to the board of directors and recorded in the shareholder registry in the corporation, which every corporation has to maintain and which includes names of shareholders, their nationality, place of residence, and shares’ numbers. *See generally* articles 24—30 for further details about the information that has to be in a mortgage contract.

⁵⁸⁷ *Id.* (“The pledge creditor shall receive profits and use share-related rights, unless the pledge contract stipulates otherwise.”)

assemblies nor cast the votes of mortgaged shares since these rights are only exercised by the registered owner of the shares (or his delegate).^{588 589}

2. Restrictions on Share Transfer

In spite of the fact that the share transferability is of the core features of joint-stock corporations, the Law subjects this feature to a temporarily statutory constraint, and it also allows the corporations to restrict this right. Nevertheless, these both restrictions do not negate the statutory protection of the right as explained hereunder. As a matter of fact, they, I believe, should be perceived as protection for the shareholders rather than external constraints upon the shareholder's rights.

a. Statutory Restriction

In exception to the principle of free transferability of shares, the Law precludes the incorporating shareholders from disposing of their shareholdings during the following years of the incorporation. Only after the publication of the corporation's financial records and statements of two fiscal years may shareholders sell their shares.⁵⁹⁰ Through an analytical lens, such a restriction, one may deduce, accords twofold protection.

First, it protects the third parties (e.g., potential buyers) from being deceived or lured into a fraudulent business. At the oust of the business, it is unlikely to accurately evaluate the business's success and thus pay the fair value for its shares.⁵⁹¹ After two years, nonetheless, the potential buyer is in a better position to assess the business and estimate how much the corporation's shares

⁵⁸⁸ See *supra* note 518 and accompanying text.

⁵⁸⁹ Article 112 forbids "pledge creditors" from attending and voting in shareholder assemblies.

⁵⁹⁰ Article 107 (1) ("Shares subscribed by incorporators may not be tradable except upon publication of the financial statements for two fiscal years, each is not less than twelve months, as from the date of the company's incorporation.")

⁵⁹¹ To ensure such protection is provided for third parties and communicated to the outside world, the Law requires the certificates of shares be marked with the date of the incorporation of the corporation and the restriction period for trading. Article 107 (1).

deserve, given its financial records and statements of its two fiscal years, which should reflect the corporation's performance and lucrativeness.⁵⁹²

Second, which is more relevant to the present discussion of this chapter, this statutory restriction ties the interests of the minority shareholders with the interests of the controlling ones, who have the upper hand in managing and operating the business. By the exercise of imagination, if the business were falling apart or seemed fruitless, the controlling shareholders—by virtue of the superior and managerial status— might exit the corporation by selling their controlling shareholdings and leaving the minority shareholders stuck in the failing business. The beginnings of businesses are of the most challenging time a business may undergo, so the minority shareholders are better off with this statutory restriction because of the sense of reassurance it produces that they are sailing through the whirlwind with other controlling shareholders on the same boat.

Most importantly, during the two-year trading ban, the Law exempts some forms of transferability.⁵⁹³ Allowable trading includes the transfer of shares among existing shareholders,⁵⁹⁴ and the transfer of shares to the heirs of a deceased shareholder.⁵⁹⁵ In addition, the Law permits the transfer of shares that transpires as a result of enforcement against the insolvent shareholder's shares,⁵⁹⁶ yet the other shareholders enjoy the right of first refusal in such cases.⁵⁹⁷ After all, both of the exceptions prove the rule.

⁵⁹² Note that, not only does the Law require the elapse of two-year period in order for shareholders to sell their shares, but also it requires that such passage is to be accompanied with publication of the financial records and statements of the corporation, which underscores the message underlying such requirements for third parties.

⁵⁹³ Article 107 (2).

⁵⁹⁴ *Id.*

⁵⁹⁵ *Id.*

⁵⁹⁶ *Id.*

⁵⁹⁷ *Id.*

b. Corporate Restrictions

Worldwide, the tradability of close corporations' shares oftentimes undergoes some restrictions imposed by the shareholders themselves for a variety of reasons, such as to prevent the shares from being sold to outsiders with no personal or familial relationships to the rest of shareholders. The small number of shareholders in close corporations and the interpersonal relationships among shareholders make it sensible for the shareholders to restrict the free tradability feature of shares. The most prevalent form of share resections is the right of first refusal. This restriction is widely recognized by corporate law,⁵⁹⁸ including the Saudi Companies Law of 2015.⁵⁹⁹

Nevertheless, to ensure that the shareholder's discretion is neither abused nor exploited in a way that contradicts the general principle (free transferability), the Law prohibits the corporations from imposing restrictions that implicitly render shares untradeable.⁶⁰⁰ An example of an outlawed restrictions is that requiring shares be sold exclusively to shareholders while no one wants to buy. Even if the shareholders agree to the provision, this provision violates a statutory right, and thus it is void and null under the Law.⁶⁰¹ The essence of the contractual restrictions on share tradability should design a mechanism by which shareholders sell their shares, not create a blanket ban that eliminates the shareholder's right to transfer shares.

⁵⁹⁸ See, e.g., DEL. CODE ANN. tit. 8. § 202 (2006); MODEL BUS. CORP. ACT § 6.27 (2016) (authorizing contractual restrictions on the transfer of shares).

⁵⁹⁹ As matter of fact, the Law recognizes the right of first refusal for shareholders of close corporations in a couple of instances in the Law. Both instances asserts shareholders' right of first refusal if a shareholder's shares are subject to enforcement due to shareholder's insolvency or bankruptcy. As a side note, there is a major difference between the two terms: insolvency and bankruptcy, and thus the laws and regulations concerning them.

⁶⁰⁰ Article 108, ("The company's articles of association may provide for restrictions related to trading of shares, provided that such restrictions do not lead to permanent ban of trading of such shares.")

⁶⁰¹ See *supra* note 576.

3. Mandatory Offering

A unique rule that has been introduced by the Competent Authority and appears to account for the protection for the minority shareholders is the mandatory offering.⁶⁰² The uniqueness of this rule finds its roots in the fact that it is commonly imposed on shareholders of public corporations, not close ones.⁶⁰³ According to the ministerial resolution, if the ownership of the shareholder in the corporation exceeds 50% of the corporation's capital by means of share purchase (in one or multiple transactions), that shareholder has to offer the remaining shareholders (the minority) to buy their shares for the best of the prices and terms the acquiring shareholder paid for the shares during the last 12 months prior to the offer date.⁶⁰⁴ From the perspective of an advocate for the minority shareholders rights, this rule represents protection for minority shareholders' interests against the unexpected rise of the controlling shareholder or a sudden change of control—especially if the corporation has no controlling shareholder—and thus the dilution of share value and power.⁶⁰⁵

⁶⁰² Ministerial Resolution, No. 32565, Fifth.

⁶⁰³ See generally Zohar Goshen; Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L. J. 560, 617 (2016); Stephanie Luiz; Kathleen Van der Linde, *The Mandatory Offer Obligation and Intermediaries*, 2011 J. S. AFR. L. 113, 126 (2011); S. M. Luiz, *Protection of Holders of Securities in the Offeree Regulated Company during Affected Transactions: General Offers and Schemes of Arrangements*, 26 S. AFR. MERCANTILE L.J. 560, 586 (2014).

⁶⁰⁴ In addition, the acquiring shareholder has to make the offer to other shareholders during the following 60 days after his shareholding crosses the 50% threshold. See Ministerial Resolution, No. 32565, Fifth.

⁶⁰⁵ Notwithstanding the protection mandatory offering provides, this rule is surrounded by grave concern. By thorough reading and analyzing of the Law, I think that the Competent Authority crossed the boundaries the legislative branch drew in the Law. According to the Law, the Competent Authority is empowered to issue whatever necessary for the implementation of the Law (Article 225,2). However, this rule, I think, is beyond its statutory power because it effects a new substantive obligation the Law has neither mentioned nor implicated. Unless this rule becomes part of the Law through the right channel, I am skeptical about its legality and enforcement in a court of law. As far as I know, this rule is under reconsideration by the Competent Authority as of March 2018.

D. Corporate Share Repurchase

Repurchases of shares is a tool that alters the structure of the corporation's share capital.⁶⁰⁶ As a matter of fact, it is a form of distribution by the corporation.⁶⁰⁷ During its lifetime, the corporation may decide to buy back its shares for an assortment of operational and financial causes. Such causes (stipulated in the Law) include decreasing the corporation's share capital to tackle losses, or awarding shares to its employees.⁶⁰⁸ Unlike these reasons, which seem to be legitimate and for good cause, the repurchase of shares may be driven by corrupt intents, such as the oppressive elimination of a dissenting shareholder or by opportunistic appropriation of a larger portion of corporate profits,⁶⁰⁹ which has generated the abusive practice of what is so-called "selective repurchase".⁶¹⁰

The selective repurchase denotes that the corporation buys back some of its shares—that are in the hand of selected shareholder(s)—upon favorable conditions and prices to the latter, depriving other shareholders (the minority) of benefiting from the repurchase.⁶¹¹ Because share

⁶⁰⁶ Cf. Victor Brudney, *Equal Treatment of Shareholders in Corporate Distributions and Reorganizations*, 71 CAL. L. REV. 1072, 1072 (1983).

⁶⁰⁷ E.g., MODEL BUS. CORP. ACT § 1.40 (2016) (The definition of "a distribution includes the payment of a dividend, a purchase by a corporation of its own shares [emphasis added], a distribution of evidences of indebtedness or promissory notes of the corporation, and a distribution in voluntary or involuntary liquidation.")

⁶⁰⁸ See Kathleen van der Linde, *Share Repurchases and the Protection of Shareholders*, 2010 J. S. AFR. L. 288, 288—289 (2010) (citing other reasons behind corporate repurchases, such as are reduction of administrative costs, perseverance of control in case of repurchasing the shares of perished or retiring employee).

⁶⁰⁹ *Id.* ("Getting rid of a troublesome shareholder is another motivation."); Languta A. Manganye, *Selective repurchases of Shares and Protection of Shareholders in terms of the Companies Act 71 of 2008* (2016) (published L.L.M. Thesis, University of Johannesburg) (on file with the author).

⁶¹⁰ The term "selective repurchase", however, is coined in the Saudi Law; unlike some other jurisdictions (e.g., South Africa and New Zealand), the Law regulates repurchases in a broader scope in a way that bans selective share buybacks, completely. See Languta A. Manganye, *Selective repurchases of Shares and Protection of Shareholders in terms of the Companies Act 71 of 2008* (2016) (published L.L.M. Thesis, University of Johannesburg) (on file with the author) (comparing between South Africa and New Zealand's regulations of repurchases).

⁶¹¹ In addition to selective repurchases, another abusive form of repurchase is the proportional repurchase provided that such a repurchase occurs with the knowledge that shareholders are unable to accept the

buybacks may give rise to oppression against the minority shareholders (e.g., freeze-outs),⁶¹² the Law prescribes some mandatory rules that ensure the application of the equity doctrine in such circumstances, deterring the controlling shareholders from misusing corporate repurchases for vicious drives.⁶¹³

Based on the Law,⁶¹⁴ the corporation may buy back its shares only in three events: to decrease the share capital,⁶¹⁵ to retain treasury shares,⁶¹⁶ or to redeem shares.⁶¹⁷ The discussion hereunder is narrowed to crystallize the protection for the minority shareholders underlying the procedural requirements the Law stipulates to guarantee that all shareholders have the chance to render their shares in lieu of discriminatory repurchases of selected shareholders' shares.

1. Share Repurchase for Capital Decrease

The protection of minority shareholders against abusive repurchases is signified in a number of procedural rules that together establish a mechanism of fairness and equity among all

offer. For further information, see Kathleen van der Linde, *Share Repurchases and the Protection of Shareholders*, 2010 J. S. AFR. L. 288, 289 (2010).

⁶¹² See *supra* Chapter 1. Part II. D. (explaining what freeze-outs mean and how they occur).

⁶¹³ Note that not only are procedural rules the statutory approach to protect shareholders from abusive repurchase, but also they may be protected through fiduciary duties and the principle of fairness. In the United States, for example, repurchase decisions in principle are regulated of the board's duty of utmost good faith and equal opportunity rule for all shareholder, in many states. Accordingly, shareholders have the right to have their shares repurchased or redeemed; otherwise, non-selling shareholders have to approve of selective repurchases. See Kathleen van der Linde, *Share Repurchases and the Protection of Shareholders*, 2010 J. S. AFR. L. 288, 297—298 (2010).

⁶¹⁴ Article 112 (1) permits corporations to repurchase its shares in accordance with the rules set by the competent authority, the Ministry of Commerce and Investment in case of close corporations.

⁶¹⁵ Article 144 stipulates that corporations may decrease their share capitals under one of two conditions: First, the share capital is in excess of the need of the corporation. Second, the corporation incurs losses.

⁶¹⁶ See *infra* note 625.

⁶¹⁷ The Law allows corporations to issue callable or redeemable shares. See generally Article 111 (regulating the issuance and redemption of callable shares). Repurchases due to the corporation right to redeem its shares is excluded as it falls beyond the concern of this research, and since such shares are presumably owned or purchased with the knowledge that these shares are callable, which differs from share repurchase due to decreasing share capital or retaining treasury shares as repurchases for such causes are aimed at non-callable shares and with no prior shareholder's expectations of such repurchase.

shareholders.⁶¹⁸ First of all, as seen earlier, the decision to decrease the corporation's capital is of the exceptional corporate matters that require a higher quorum and higher decision-passing percentage to approve of it,⁶¹⁹ which ensures a greater role played by the minority shareholders in the decisions. Furthermore, it is not a mere decision to decrease the corporation's share capital, but rather it includes (in case of approval) specifications such as the number of shares to be repurchased, the price, and the terms for the repurchase offer.⁶²⁰

Moreover, the Law mandates that the corporation notify all shareholders of its resolution to buy back a certain amount of their shares.⁶²¹ This ensures that all shareholders are acutely aware of all the necessary information about the repurchase transaction and gives them equal opportunities to sell their share back to the corporation.

Most importantly, the repurchase price is to be "fair".⁶²² Despite the fact that there are an array of determinants affecting the fair value of close corporation's shares along with the fact that there is no clear-cut definition of what constitutes "fair value",⁶²³ the shareholders are not coerced to sell their shares at the end. Instead, they have the ultimate freedom to accept or reject the offer if they think that their shares are underpriced. The absence of the ready market poses a heavy burden

⁶¹⁸ As a sideline, the Law extends its protection to encompass creditors of the corporation as well. In case the repurchase of shares is for the purpose of decreasing share capital due to its excess of the corporation's needs, the repurchase decision is to be communicated to the creditors who have 60 days to raise their objection to the decrease of the corporation's share capital. If such an objection is raised during the statutory 60-day period, the corporation has to either pay the debt if it is due, or provide the creditor with a sufficient guarantee if the debt is not due. Article 145.

⁶¹⁹ See *supra* Chapter 3. Part II. A. 2 (b); Article 12 (H) of the RRP.

⁶²⁰ Article 12 (H) of the RRP.

⁶²¹ Article 148 (1) ("The call shall be made by notifying shareholders of the company's wish to repurchase shares by registered mail or by publication in a daily newspaper distributed in the area where the company's head office is located.")

⁶²² Article 148 (3).

⁶²³ On the other hand, public corporations may rely of the market to determine the fair value of shares. As a matter of law, public corporations may fix the repurchase price not exceeding 5% of the closing price on the day preceding the day the repurchase transaction is finalized. See Article 12 (6) of the RRP of Listed Companies.

upon the close corporations to fashion an attractive deal in a way that incentivizes shareholders to vend their shares, avoiding overpricing and underpricing.⁶²⁴

2. Share Repurchase for Retaining Treasury Shares

At times, the corporation may seek to repurchase its shares to retain them as treasury shares.⁶²⁵ Treasury shares may be piled up only for a collection of statutory purposes.⁶²⁶ The purposes are awarding the corporation's employees as part of employee share ownership plan,⁶²⁷ share swap,⁶²⁸ or fulfilling the right of the holders of convertible bonds to convert their debt instruments into shares.⁶²⁹

A number of procedural requirements are prescribed by the Law to achieve adequate protection for the interests of the minority shareholders. Once again, the repurchase of shares for the treasury-share purposes has to be approved by a resolution of the extraordinary shareholder assembly,⁶³⁰ yet this resolution does not require the same stringent resolution-passing percentage required to repurchase shares for the capital decrease.⁶³¹ In addition, the fraction of shares the corporation may

⁶²⁴ See Marvin A. Chirelstein, *Optional Redemptions and Optional Dividends: Taxing the Repurchase of Common Shares*, 78 YALE L.J. 739, 743—744 (1969); Kathleen van der Linde, *Share Repurchases and the Protection of Shareholders*, 2010 J. S. AFR. L. 288, 289 (2010).

⁶²⁵ Treasury shares are repurchased shares the corporation retains for different future purposes, such as employee share ownership plan. Most importantly, repurchase of shares for purposes other than decreasing the share capital due to losses are to be stipulated in the corporate charter and bylaws. Article 1 (C) of the RRP.

⁶²⁶ Article 13 of the RRP.

⁶²⁷ The employee share ownership plan is a program that is adopted voluntarily by the corporation in its corporate charter or bylaws, which allow it to confer some of its treasury shares on its workforce. See Article 137 (2) (empowering the extraordinary shareholder assembly to decide on granting its employees some shares in the corporation as part of incentives).

⁶²⁸ A share swap is a transaction via which exchanges of shares of different corporations take place in various forms. In the context of mergers and acquisitions, for instance, a target corporation's shares are exchanged for the shares of acquiring corporation. See Article of 13 (B) of the RRP (limiting the retaining of treasury shares for, inter alia, [s]hare swap transactions for the acquisition of shares or limited liability company's interests or an asset purchase").

⁶²⁹ Article of 13 (A) of the RRP.

⁶³⁰ See *supra* Chapter 3. Part II. A. 2. (b).

⁶³¹ Remember, a share capital decrease is one of the corporate matters for which the Law requires the approval of three-quarter of the shares attending the extraordinary shareholder assembly, while

retain as treasury shares are limited. According to the Law, the treasury shares of the close corporation may not exceed 10% of the corporation's aggregate shares, at all times.⁶³² Otherwise, the corporation, namely the controlling shareholders, would abuse the option to exhaust the corporate cash to make the corporation repurchase their shares, and thus channel corporate profits to the vending shareholders.

3. Repurchase as Part of Employee share ownership Plan

The Controlling shareholders may exploit treasury shares in a way that puts these shares in their possession—as employees of the corporation. To curb such a theoretical—but practically possible—assumption, the Law goes above and beyond to set forth a number of rules that promote protection in the face of the potential abuse of the employee share plan by the controlling shareholders. First of all, the extraordinary shareholder assembly has to approve of the plan as well as the permission of the corporation's bylaws to adopt such a plan.⁶³³ Second of all, non-executive directors of the board may not benefit from the plan,⁶³⁴ and most importantly the executive directors may not cast their votes on any employee-share-related matter that is the subject of the board's deliberating and voting.⁶³⁵

As an observer may find in these rules rigorous requirements, they, from the viewpoint of minority shareholders, constitute a protective shield against opportunism and oppression. They ensure that the shares are repurchased and re-issued for the sake of the corporation's employees, rather than a way to augment their shareholdings. Evidently, these requirements safeguard the

repurchases for share-treasury purposes requires the default percentage approval of two-thirds of the shares attending the extraordinary shareholder assembly. *See supra* Chapter 3. Part II. A. 2. (b).

⁶³² Article 12 (C) of the RRP.

⁶³³ Article 21 (A) & (B) of the RRP (The extraordinary shareholder assembly may designate to the board the power to determine the plan's details, including the price if it is offered for consideration.)

⁶³⁴ Article 21 (C) of the RRP.

⁶³⁵ Article 21 (D) of the RRP.

integrity of the decision related to such a repurchase, and they make sure that the decision is not tainted or driven by personal benefits of the controlling shareholders, who presumably control the board and manage the day-to-day operations.⁶³⁶

E. Regulation of Related-Party Transactions

In a number of instances, the controlling shareholders may engage in self-dealing transactions, or they may benefit directly or indirectly from some of the transactions they execute while wearing the hats of directors or officers. These transactions raise concern about their fairness to the corporation, and whether they are detrimental to the interests of other shareholders. In response, most jurisdictions, if not all, impose a set of regulatory rules to uphold the equality doctrine among shareholders, and deter or eliminate transactions that may harm the minority shareholders' interests. Nevertheless, the legal devices adopted to tackle related-party transactions vary from country to the other.⁶³⁷

As far as the statutory protection for the minority shareholders within Saudi Arabia is concerned, the Law has approached the related party transactions with a set of legal rules that

⁶³⁶ To illustrate how these rules prevent an abusive repurchase in a real life example, let us assume that X is a controlling shareholder of Y corporation, whose board is presided by X, who appointed his son, Z, to the corporation's CEO post as well as to a seat of the board. The Y corporation decides to launch an employee share ownership program, which is permissible by Y's bylaws. The board has been designated the power to start the program. For the sake of the presented argument, X's intent to launch the plan appears to be for the corporation's employees' interests, yet the ulterior motive is to enlarge his and his son's shareholdings. With these rules in play, however, X may not benefit from this plan at all because he does not fit the definition of employee for the sake of the plan. Plus, Z, the CEO and director of the corporation, may not cast his vote to approve of such a plan due to a conflict of interests because he fits the definition of corporate employee and thus benefits from the plan.

⁶³⁷ See REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 145 (Oxford Univ. Press 3rd. ed. 2017) (defining party-related transactions as "these include both transactions in which related parties such as directors and controlling shareholders deal with the corporation—traditional self-dealing and managerial compensation—and transactions in which related parties may appropriate value belonging to the corporation—the taking of corporate opportunities and trading in the company's shares"). Party-related transactions fall within a wider scope known as "tunneling". This term is first used by Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Tunneling*, 90 AM. ECON. REV. 22 (2000), to characterize the expropriation of minority shareholders in the Czech Republic.

mandate disclosure and shareholder approval on the one hand, and prohibit sort of conflicted transactions on the other hand. They collectively forestall the related-party transactions, including self-dealing and the misappropriation of corporate opportunity, at least in theory.⁶³⁸ The discussion hereunder may be found repetitive of what is stated in the earlier chapter under the subsection of the Duties of the Board; however, this subsection differs as it embraces the role of the minority shareholders and review these rules in light of their standpoint.

1. Mandatory Disclosure

One of the devices the Law adopts to curtail suspicious transactions involving conflicts of interests and probable misappropriation of wealth that belongs to the corporation is the obligation to disclose. Mandatory disclosure is one of the effective legal mechanisms that has been decoded in the corporate literature as a tool that, *inter alia*,⁶³⁹ warns the shareholders of questionable conduct by the controlling shareholders and the management team.

According to the Law, transactions and contracts that involve direct or indirect benefits to a member of the board may be executed only after the board obtains the permission of the general shareholder assembly.⁶⁴⁰ The chairperson has to report to the assembly about the suspicious transaction and request its authorization from the shareholder assembly.⁶⁴¹ To ensure that the shareholder assembly is fully informed, it is of the external auditor's duty to review the questionable transaction and submit a report about its fairness to the shareholder assembly.⁶⁴²

⁶³⁸ Note that whether the regulatory apparatus succeeds in deterring controlling shareholders and directors from engaging in such transactions is an empirical question that falls beyond the scope of this study.

⁶³⁹ See REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 147 (Oxford Univ. Press 3rd. ed. 2017) (asserting that mandatory disclosure also supports the “internal decision-makers’ independence and ensures compliance with the Law and the corporation’s bylaws).

⁶⁴⁰ Article 71 (1).

⁶⁴¹ *Id.*

⁶⁴² *Id.*

Although this requirement yields advantages, some concerns are surrounding the statutory prescription of this requirement. First, the Law fails to define what constitutes a direct or indirect benefit, making it ambiguous for the obligees to comply with this requirement. The ambiguity includes, for example, whether the benefit has to be pecuniary, to what extent an indirect benefit may stretch, and whether the size of the benefit matters. Another concern is that compliance with this rule as described in the Law is seemingly prohibitive and does not mesh with the doctrine of delegated management. The corporation engages in many transactions, so seeking the approval of shareholders as a whole every time a potential conflict of interest transaction pops up is inefficient, economically and intuitively. The board may forgo good deals just to avoid the lengthy—and costly—requirement to call for an assembly and seek its approval.⁶⁴³

Furthermore, the Law imposes an obligation to disclose and report the remuneration packages of the board's directors to the shareholders.⁶⁴⁴ The compensations of directors oftentimes give rise to conflicting interests. Therefore, this obligation—along with other constraints imposed by the Law—constitutes an effective mechanism as the board has to report to the shareholder organ compensation-related details, including their monetary and in-kind benefits, other amounts received by the member of the board under another capacity (e.g., CEO), and the number of meetings attended by the member.⁶⁴⁵

In sum, the mandatory disclosure is a vital apparatus to keep the management of the corporation in check, to prevent any expropriation of the corporation's wealth, and to alert the minority

⁶⁴³ Although the Law provides for an exception that the general assembly may allow the board to decide on related-party transactions, this rule still makes legitimate related-party transactions subject to scrutiny and require approval. In addition, the permission for the board to decide conflicted transactions is temporary; it may be granted for only one year, subject to renewal. Article 71 (1).

⁶⁴⁴ Article 76 (4).

⁶⁴⁵ See *supra* Chapter 3. Part III. G. for a comprehensive explanation of the governing rule of directorial compensations.

shareholders of any red-flag-raising transaction. Nonetheless, the status quo of the mandatory disclosure may be baffling and overregulating as the definition of direct and indirect benefit is still undetermined, and as the reporting system poses cumbersome procedures that do not match with the rapidity involving the business sector. After all, this does not negate the significance of the informative role played by the mandatory discourse in protecting the minority shareholders.

2. Shareholder Approval

Another effective device to eliminate related party transactions is the statutory requirement of shareholder approval. The Saudi Law, unlike other jurisdictions,⁶⁴⁶ imposes a blanket approval requirement for every conflicting-interest transaction.⁶⁴⁷ Moreover, the Law mandates the transaction-related party abstain from voting on the matter in question.⁶⁴⁸ The abstention empowers the minority shareholders in cases where the party is the controlling shareholder. In such cases, the transaction is approved by a majority of the minority of shareholders.

3. Prohibition of Conflicted Transactions

To curb opportunistic and self-dealing transactions, the Law bans some types of transactions where directors' interests—or the controlling shareholders'—are present at both ends of the transactions. For instance, corporations may not grant any forms of a loan to its directors or shareholders alongside the prohibition that the corporations may not serve as guarantors of the shareholders and directors' loans.⁶⁴⁹

⁶⁴⁶ *E.g.*, the United States, the United Kingdom, Japan, Germany, France, Italy, and Brazil.

⁶⁴⁷ *But cf.* REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 156 (Oxford Univ. Press 3rd. ed. 2017) (“No jurisdiction [the United States, Japan, Germany, France, Italy, and Brazil] mandates across- the- board shareholder approval for related-party transactions, not even with controlling shareholders. This is because doing so might be excessively cumbersome. . .”).

⁶⁴⁸ Article 71 (1) (“Said member [with conflicting interests] may not participate in voting on the resolution to be issued on this matter by the board of directors and the assembly of shareholders.”)

⁶⁴⁹ *See supra* Chapter 3. Part III. E. for elaborate illustration of this statutory prohibition as a matter of director's duties.

Another prohibition that signifies the statutory protection of shareholders' interests is barring the board's directors from competing against the business they are supposed to advance its interest.⁶⁵⁰ This prohibition may be waived only if the shareholder general assembly authorizes the competition in question. Otherwise, competing against the business without obtaining proper authorization makes the violating director subject to the removal, litigations, and the damages. Note that this prohibition stretches over business activities within the corporate line of the business.⁶⁵¹

In the same fashion, insider trading is a ubiquitous example of a conflict of interest that is forbidden in most jurisdictions, if not all. Insider trading includes the disclosure of secret information they obtain by virtue of their directorships to unauthorized persons, and the trading on such information to gain or direct to someone else personal benefits.⁶⁵² Albeit an old argument in the literature that insider trading may yield some benefits,⁶⁵³ violators under the Law are subject to removal from the board as well as to civil liabilities.⁶⁵⁴

Despite the obscurity of some rules regulating the related-party transactions, these rules provide an acceptable level of statutory protection for minority shareholders. The flow of information into shareholders and the shareholder-approval rule go hand in hand to thwart dubious practices and contracts executed by interested parties, as well as the ban on the competition and the personal loans to the management and the directors of the board. The prohibition of insider

⁶⁵⁰ Article 72.

⁶⁵¹ *Id.*

⁶⁵² Article 74.

⁶⁵³ Such benefits include that it constitutes a type of *incentive* remuneration and it provides a “superior channel of non-public information” embedded in the share price. *See* REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 160 (Oxford Univ. Press 3rd. ed. 2017); HENRY G. MANNE, *INSIDER TRADING AND THE STOCK MARKET* (1966); Dennis W. Carlton; Daniel R. Fischel, *The Regulation of Insider Trading*, 35 *STAN. L. REV.* 857, 896 (1983).

⁶⁵⁴ Article 74.

trading as part of the Law is logically necessary, yet its importance in the context of close corporations may be marginalized as the insider trading is an issue that is associated with the listed corporations.

F. Shareholder Derivative Actions

The right to bring lawsuits against the corporation and its management is of paramount importance to the protection of the minority shareholders.⁶⁵⁵ It represents a statutory tool available to the shareholders to hold the management of the corporation liable for its wrongdoing and seek a judicial remedy based on the oppression of the controlling shareholder or based on a violation of the governing law and documents (e.g., corporate charter and bylaws). Note that the protection of the minority shareholders through shareholder actions is not a mere matter of recognizing the right, but rather it is a matter of the procedural rules that regulate shareholder actions. In the United States, for instance, the board has a great deal of discretion to whether allow shareholders to bring a derivative against the management.⁶⁵⁶ This rule makes the shareholder right to sue the corporation more tentative than protective as it poses a limitation on the right.

⁶⁵⁵ Accord Julian Javier Garza, *Rethinking Corporate Governance: The Role of Minority Shareholders – A Comparative Study*, 31 ST. MARY'S L.J. 613, 636 (2000) (“Minority shareholders may not control the company, but their role in a corporation through. . . derivative suits influences corporate governance and makes minority shareholders significant players in the corporate world.”); F. Hodge O’Neal, *Oppression of Minority Shareholders: Protecting Minority Rights*, 35 CLEV. ST. L. REV. 121, 139-40 (1987) (confirming the use of derivative suits by minority shareholders against controlling shareholders wearing the hats of directors or officers).

⁶⁵⁶ The requirements to bring derivative action against the corporation and its incumbent management vary from state to state. One of the most commonplace requirement is the contemporaneous ownership requirement, which mandates that shareholders bringing the suit has to have been a shareholder of the corporation at time of the alleged harm that affected the corporation. *See* Wessin v. Archives Corp., 581 N.W.2d 380, 385 (Minn. Ct. App. 1998) (determining the nature of derivative actions); MODEL BUS. CORP. ACT §7.41 & 7.44; MICHAEL A. CHASALOW, *EXPERIENCING BUSINESS ORGANIZATIONS* 549 (WEST ACAD. PUB. 2014).

In Saudi Arabia, nevertheless, the Law recognizes the shareholder's right to sue the corporation and takes arguably a lenient approach in setting the governing rules of shareholder actions.⁶⁵⁷ For example, the Law does not require the shareholders to obtain the approval of the board to file an action. Instead, it sets forth a cluster of statutory requirements that once are met, the shareholder has the right to file the case against the corporation. As demystified hereunder, the statutory requirements are more procedural than substantive, yet they make shareholder actions powerful instruments in the hand of the minority shareholders, conceptually.

Derivative Action Requirements

One of the statutory rights shareholders enjoy is the right to bring a suit on the corporation's behalf.⁶⁵⁸ These lawsuits claim that harm has disturbed and hurt the welfare of the corporation, and the shareholders (as the ultimate owners of the corporation).⁶⁵⁹ Therefore, the relief sought in derivative actions belongs to the corporation, not to the shareholders filing the action. In short, derivative actions stem from the wrongdoing done to the corporation.

The Law establishes two ways to bring actions vis-à-vis the corporation. The first sort of derivative actions is an action that brought pursuant to a resolution by the shareholder general assembly. According to the Law, the shareholder general assembly has the power to sue the directors of the board because of their wrongdoing or mismanagement that results in harm to the corporation, and thus shareholders—as a whole.⁶⁶⁰ Needless to say that the resolution to sue the management is subject to the regulating rules of the shareholder general assembly (e.g., quorum

⁶⁵⁷ Article 110 (“Shareholders shall have all rights associated with shares, particularly the rights to . . . [initiate] a liability suit against Board members and appealing resolutions issued by shareholder assemblies.”)

⁶⁵⁸ Article 88 (a.v.) forbids the elimination or deprivation of shareholder's right to sue the board of directors, declaring this right as a statutory right that may not be altered or modified.

⁶⁵⁹ Cf. MICHAEL A. CHASALOW, EXPERIENCING BUSINESS ORGANIZATIONS 549 (WEST ACAD. PUB. 2014).

⁶⁶⁰ Article 79.

and resolution-passing requirements).⁶⁶¹ In practice, it may be difficult, if not impossible, for the minority shareholders to bring a derivative action by means of the assembly resolution, mainly if the controlling shareholder also serves on the board as a chairperson or director. Logically, no shareholder votes to bring a suit against themselves. For this reason, the Law advances another way to file the derivative action.

Alternatively, the derivative action may be brought by the shareholder—as an individual. The individual shareholder may seek judicial intervention to redress the violation of the corporation’s right on behalf of the latter. Based on the Law, if the shareholder general assembly fails to act or decide not to sue the corporation’s board of directors, the shareholder may file the action instead provided that the statutory requirements for the derivative action by the shareholder are met. The first requirement is that the suing shareholder establish the harm to his interest due to the board’s wrongdoing,⁶⁶² which is unusual since derivative suits are brought on behalf of the corporation and for damages sustained by the shareholders as a whole.

One may interpret that the Law fails to distinguish between derivative and direct action. However, the second requirement requires the validity of the corporation’s right to bring the lawsuit. The Law mandates that the corporation’s right to sue the board exists and has not yet expired.⁶⁶³ The Law sets a statute of limitations of three years from the date of discovering the wrongful deed.⁶⁶⁴ If the affected shareholder fails to act during this time, he loses his right to bring the derivative action.

⁶⁶¹ See *supra* Chapter 3. Part II. A.2(a).

⁶⁶² Article 80.

⁶⁶³ *Id.*

⁶⁶⁴ Article 78 (3) (“A liability suit shall not be heard after the lapse of three years from the date of discovering the wrongful act. Except for fraud and forgery, a liability suit shall not be heard after the lapse of five years from the end of the fiscal year in which the wrongful act was committed, and three years from the expiration of membership term of the concerned member, whichever occurs later.”)

The third requirement is that the prejudiced shareholder alert the board of the intention to file a derivative action.⁶⁶⁵ Note that it is merely a notification; no approval from the board is required. The fourth requirement, which also seems unconventional to the concept of the derivative suit, is that the judicial remedy be limited to the damages sustained by the suing shareholder,⁶⁶⁶ while the traditional understanding is that remedies based on derivative suits belong to the corporation.

Admittedly, there is perplexity in the differences between the two ways to bring a derivative action. One may think of the second way as a substitute for the direct action since the affected shareholder has to establish personal harm along with the fact that the remedy is limited to that sustained harm. On the other hand, the confusing requirement of the existence of the corporation's right and the description of this suit as a derivative suit in the Law may lead others to consider it as a derivative suit of special nature. Otherwise, what would be the kind of actions the shareholder might bring if the corporation sustained no harm, but the shareholder did? Furthermore, the requirement that the shareholder prove that the harm to the corporation results in personal harm to his interest makes it impractical as the harm is presumably impossible to prove; otherwise, the shareholder would bring a direct action if the harm were demonstrable.⁶⁶⁷

One idea to address the confusion of the current procedural requirements for derivative actions in a way that will strengthen the protection for the minority shareholders is the adoption of abstention rule. Under this rule, I propose, the shareholder—especially controlling one—who is also a director of the board would not cast his vote in deciding whether to bring a derivative suit against the board due to an existing conflict of interest. A rational shareholder would never vote

⁶⁶⁵ Article 80.

⁶⁶⁶ *Id.*

⁶⁶⁷ A direct action is the traditional type of action that a shareholder bring in their name vis-à-vis the corporation, a director, or an officer of the corporation because an wrongful act that results in a direct injury to their interest. Needless to say that direct actions are governed by the Civil Procedures Law as a tort liability lawsuit. Explained in next chapter.

in favor of a lawsuit against him. In support of this idea, the Law has recognized this use of rule when it comes to deciding the remunerations of the board's directors,⁶⁶⁸ so it is not a novel device deployed by the Law. If adopted, this rule would empower the minority shareholders who had no representation on the board (even with the use of cumulative voting in the appointment of directors) to challenge the board's decisions and hold its members accountable for their negligence and misconduct by means of a derivative suit brought by a majority vote of the minority shareholders.

Part IV. Evaluation of the Statutory Protection of Minority Shareholders

This Part bisects into two sections. The first section sheds light upon the role of formalism throughout the Law to establish a primary source of the statutory protection for minority shareholders. My analysis's goal is to accentuate the positive of the Saudi approach in addressing minority shareholder's issues in close corporations by form, rather than substance. The second section voices some concern surrounding the statutory protection of minority shareholders as it emboldens them to oppress majority shareholders or frustrate corporate management.

A. The Formalities of the Law

Having investigated a variety of prescriptive rules of the Law consisting the statutory protection for the minority shareholders, it is evident that the Law, similar to most corporate laws, abounds with formalism.⁶⁶⁹ Unlike other areas of the law where substance prevails, corporate laws

⁶⁶⁸ See *supra* Chapter 3. Part III. G.

⁶⁶⁹ See, e.g., *Uni-Marts, Inc. v. Stein*, CIV.A. Nos. 14893, 14713, 1996 WL 466961 (Del. Ch. Aug. 12, 1996) (“[W]hen construing the reach and meaning of provisions of the Delaware General Corporation Law, our law is formal. . . . [T]he entire field of corporation law has largely to do with formality.”); Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 427–37 (2006) (arguing that corporate laws are characterized by a high level of formalism).

have always preferred form and process. While formalism may involve different meanings,⁶⁷⁰ the term hereunder denotes the regulatory apparatus utilized throughout the Law to assert the shareholder supremacy, regard the shareholder rights, and protect the interests of the minority shareholders.

In principle, comparatively reading of the Law leads to the argument that formalism in the Law tends to favor the shareholder over the management, in a rare exception to the general premise.⁶⁷¹ While the Law defines the roles of both shareholders and directors, it entitles the shareholders to an array of powers to decide not only the shareholder affairs but also the management affairs.⁶⁷² An outstanding example, as seen above, is the requirement of the shareholder approval in different instances (e.g., the board's remunerations and issuance of shares).⁶⁷³ The exceptional expansion of the shareholder intervention in corporate matters by the Law signifies the inclination of the formalism toward shareholders. Another example of the formalism—that provides great deference to the fundamental rights of the shareholder—is the statutory inviolability for some of the shareholder's rights (e.g., election right, voting right, liquidity right, and the right to receive dividends).⁶⁷⁴ Most of these rights, if not all, are surrounded by procedural details to ensure the shareholder's exercise of his statutory rights.

⁶⁷⁰ Richard H. Pildes, *Forms of Formalism*, 66 U. CHI. L. REV. 607, 621 (1999) (differentiating between three meanings of formalism). Formality is different from formalism. “**Formality** is strict adherence to rules, manners or customs. **Formalism** is also adherence to rules, but with the emphasis on procedural minutiae regardless of substance and fairness. Both *formalism* and its adjective form, *formalistic*, are usually pejorative terms.” <https://www.thetrcompany.com/en/difference-between-formality-and-formalism/>

⁶⁷¹ Cf. Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 427 (2006) (“This formalism tends to favor directors by affording them a great deal of discretion: they may take almost any action, provided that they follow the appropriate rules.”)

⁶⁷² *But see, id.* at 430 (citing examples of cases and articles of corporate codes that displays that corporate laws excel at defining the role of directors rather than the role of shareholders).

⁶⁷³ See *supra* Chapter 4. Part III. B & E.

⁶⁷⁴ See *supra* Chapter 4. Part III.

A positive view of the formalism is the reduction of the costs associated with bargaining for these rights along with the costs of coordination of information. A framework that ensures systematic inflow of information into the shareholders with a group of rights to act on such information is a reliable tool rest in the shareholders' hands. As a matter of policy, nevertheless, it may be argued that it is unwise to vest a great deal of power in the shareholder organ in lieu of the management, such an argument defends the standpoint of directors, and therefore falls beyond the scope of the research subject.

B. The Controlling Minority Shareholder

Notwithstanding the foregoing concerns and loopholes raised about some rules of the statutory approach, as a defender of the minority shareholder's protection on the one hand, and a critic of the Law on the other, I extrapolate that the Law might have led to an unsolicited consequence that makes the minority shareholders controlling ones in the corporation. Note that the controlling minority shareholder status in this research's context does not betoken the status resulting from prior arrangements (e.g., pyramids and dual-class shares),⁶⁷⁵ but rather it means the excessive power the minority shareholder may wield as a side effect of some of the regulatory rules that are intended to protect the minority shareholders against opportunism and oppression. However, they may be utilized in bad faith to frustrate the corporate management or annoy the majority shareholders, particularly at times of shareholder tensions and clashes.

In a handful of instances, I visualize, the minority shareholders are emboldened to take advantage of and abuse the legal apparatus for vicious purposes. For example, the Law precludes

⁶⁷⁵ See Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263, 1313 (2009) ("Controlling shareholders may use arrangements such as pyramids, dual-class shares, and other mechanisms to separate cash-flow and voting rights. When such arrangements are in place, the controller can have an absolute lock on control even though it has less—and sometimes substantially less—than half of the company's cash flows.")

the shareholders on the board to cast their vote on the approval of a suspicious, related-party transaction. Legally speaking, the voting minority shareholders may refuse to approve of the transaction, albeit its fairness to the corporation, for arbitrary reasons or no reason at all. Another example is the decision of capital increase. Because the Law requires an exceptional resolution-passing vote (i.e., three-quarter of attending shares in the extraordinary assembly), one may imagine a situation where the minority shareholders indiscriminately vote against the resolution, despite the fact that an increase is sought to embark upon a sound investment.

In both examples, the minority shareholders exercise their legal rights, which means that no one may challenge or stop them, irrespective to the concealed or conspicuous drives behind their manners, and to whether they are voting rationally or irrationally. The Law does not provide a judicial ground for other shareholders (i.e., majority shareholders) or the corporation's management to challenge the abusive or oppressive exercise of rights, which may leave the controlling shareholders with no choice but to wheedle votes out of these minority shareholders every time their votes matter. Otherwise, the resolution will never be passed, regardless.

An effective option to rectify the controlling-minority-shareholder dilemma, I propose, is to establish a judicial ground in the Law to keep the minority shareholder's exercising his rights in check on the one hand, and to provide the affected shareholders with an option to sue these the minority shareholders on the ground of abusing their rights. This may be done by inserting into the Law a fairness standard that may be adjudicated in a court of law or conditioning the shareholders to exercise their statutory rights with good faith and fair dealing. The fairness standard or good faith and fair dealing is a term that paves the way for the judiciary to intervene ex post and adjudge whether the disputed exercise of the right is oppressive, case by case.

Closing Analysis

The use of the prescriptive rules—in lieu of default rules—to arrange a crowd of shareholder affairs widens the role of the shareholder in corporate governance. The stipulation of a host of statutory rights replaces the traditional “passive shareholder” with a more “functional shareholder” the Law (through its rules) invites to take an effective role in overseeing the corporation and deciding on its shareholder matters.⁶⁷⁶ From the minority shareholder’s viewpoint, the functionality of shareholder, which is expected in close corporations,⁶⁷⁷ also is espoused by virtue of statutory rules that may not be contracted out. Therefore, the merits of this approach should account into statutory protection that mitigates, if not eliminates, the minority shareholder issues as extrapolated above.⁶⁷⁸

In the popular imagination, this Saudi approach—to asserting the shareholder supremacy and the minority shareholder protection— is not immune from criticism. The proponents of the director-centric corporations raise several objections against the empowerment of shareholders.⁶⁷⁹ Although some of their arguments merit attention, they fail to recognize the upsides of the functional shareholder, which outweighs the benefits realized from the passivity of shareholders, specifically in the context of close corporations.

⁶⁷⁶ See *supra* Chapter Three, Part II, A.

⁶⁷⁷ See *supra* Chapter 1, Part II.C.

⁶⁷⁸ See *supra* Chapter Four, Part III.

⁶⁷⁹ For in-depth discussion of director supremacy, see, for example, Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 808 (2007); Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006); Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601 (2006); Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk’s Solution for Improving Corporate America*, 119 HARV. L. REV. 1759 (2006); Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2002); Melvin Aron Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CAL. L. REV. 1, 16–17 (1969).

A prevalent objection to the strong shareholder rights—as opposed to the current state of director-centric corporate laws—is the shareholder indifference.⁶⁸⁰ Because shareholders commonly have little interests in the corporation, they appear to be apathetic about corporate matters. Furthermore, the expenses the shareholder may incur in an exercise of his rights oftentimes outnumber the benefits he may obtain,⁶⁸¹ so no rational shareholder would care to exercise his rights or endeavor to effect change.⁶⁸² In addition to the counterarguments to these claims,⁶⁸³ one may add that these arguments would not exist had been there a regulatory framework that would ensure the flow of information into shareholders and thus make them informed of the corporate matters without bearing excessive costs.⁶⁸⁴ In addition, this argument may fit in the context of public corporations where there are countless shareholders. In close corporations' context, one shareholder has a greater chance to affect, given the small number of the shareholders of the close corporations.⁶⁸⁵

Another objection lodged to empowering shareholders is that shareholders are inadequate to make sound business decisions.⁶⁸⁶ This allegation stems from the notion that directors are superior to shareholders and more informed than the latter.⁶⁸⁷ This may be true, yet it should not

⁶⁸⁰ See, e.g., ROBERT C. CLARK, CORPORATE LAW 390–92 (1986); Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 526–29 (1990).

⁶⁸¹ See Julian Velasco, *Taking Shareholder Rights Seriously*, 41 U.C. DAVIS L. REV. 605, 622 (2007) ([T]he expense of remaining informed about the company exceeds the expected benefit.”)

⁶⁸² *Id.* at 623, (rebutting the notion of shareholder apathy as “it is not that shareholders do not care, but rather that they find it inefficient to over-invest in monitoring behavior. Thus, the negative connotation of the term “apathy” is unjustified.”)

⁶⁸³ *Id.* at 622–25, (defending shareholder rights against shareholder-apaty claims).

⁶⁸⁴ See *supra* Chapter Four, Part IV., A.

⁶⁸⁵ See *supra* Chapter One, Part I, B.

⁶⁸⁶ See, e.g., Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1745–49 (2006); Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1276–77 (1982).

⁶⁸⁷ See Henry G. Manne, *The “Higher Criticism” of the Modern Corporation*, 62 COLUM. L. REV. 399, 408 (1962) (“The great fault has been the lack of information available to shareholders, with a resulting inertia on the part of shareholders about corporate matters.”).

underestimate the power to supervise the corporation and access its books and records in informing shareholders better. The oversight role coupled with external auditing reports and advice—and sometimes a director at the boardroom— renders the shareholders competent enough to make business decisions. As a matter of risk-bearing, the shareholders ought to partake in the process of decision making because they ultimately will bear the risks of these decisions.⁶⁸⁸

An unavoidable yet significant line of objection is that the Law excessively regulates the corporate matters that go against the contractual nature of the close corporations. Knowing the fact that the Saudi market is a developing one, and the fact that social and economic transformations flow only from laws and regulations, one may find it justifying to utilize this approach for the higher public welfare. Evidently, laws have profound effects on reshaping individuals' behaviors and protect their interests and rights. Without them, the shareholder looks vulnerable and is left with no option but to depend upon the partial contracts.⁶⁸⁹ Furthermore, this claim subscribes to the venerable theory advanced by sociopolitical thinkers, notably Gerald Rosenberg, that refutes the overrating view of the judicial bench to effect change or spark progress in a society, solo.⁶⁹⁰ Social change is a process that involves a mountain of political, legal, and social mobilization. Social reforms that are thought to be produced by courts have been already preceded by a great deal of change through executive and legislative branches alongside the civil rights movement.⁶⁹¹ If laws have the power to bring about social change, then why would they not effect change in the business society?

⁶⁸⁸ For further rebuttal of this argument, see Julian Velasco, *Taking Shareholder Rights Seriously*, 41 U.C. DAVIS L. REV. 605, 625–27 (2007).

⁶⁸⁹ See *supra* Chapter One, Part III, A & C.

⁶⁹⁰ For further insights into this debate, see GERALD N. ROSENBERG, *THE HOLLOW HOPE: CAN COURTS BRING ABOUT SOCIAL CHANGE?* (Univ. of Chicago Press 2d. ed. 2008).

⁶⁹¹ *Id.* at 35, (“While the conditions suggest that courts can be effective producers of significant social reform, . . . they also suggest that this occurs only when a great deal of change has already been made.”)

All in all, the minority shareholder armed with a host of statutory rights should be powerful enough to deter the oppressive conduct and assert a voice in the management of the corporation. As demonstrated above, the shareholder right to cumulatively elect the members of the board enhances that shareholder's chance to engage in the management. The shareholder right to sell his interests freely is another principle establishing a fundamental right for shareholders in close corporations to exist without the fear of being stuck therein. Plus, the right to request a meeting or to inspect the corporation and access its books and records confidently avails the minority shareholders to keep the management's discretion (i.e., dominant shareholder's discretion) in check and to stay informed about corporate operations.

Chapter Five: Enforcement of the Statutory Protection of Minority

Shareholders

“To know the law is not merely to understand the words, but as well their force and effect.”

Justinian, Digest, Book 1, Title 3, 17

Motivating Hypothetical

Although their business is flourishing, Saad has expressed some frustration and been dissatisfied with the management of his father and brother because of his constant disagreement over the preferred direction of the business. He has been removed from the board and replaced by an outside director, and the corporation has not distributed dividends for the past three years despite its prosperity. His brother has prevented him from accessing the books and records of the corporation, and Saad thinks about requesting the court dissolve the corporation, for the book value of his shares is far less than his pro-rata would the corporation be liquidated. However, Saad is confused about in which Saudi courts he should file the lawsuit, and he is uncertain about his odds of prevailing though he is acutely aware that it is of his statutory rights to receive dividends, to access the corporation's books and records, and to request a court-ordered dissolution of the corporation.

The Scope of Chapter Five

This chapter scrutinizes the second component of the research theory, the enforcement of the Law in Saudi Arabia as it is a major player in protecting minority-shareholder interests. Laws and rules alone do not suffice to protect minority shareholders. Instead, they are to exist interdependently. For this reason, this chapter expounds the role of the judiciary ex post, as it is the sanctuary for all disgruntled and oppressed shareholders on the one hand, and the principal enforcer of the law on the other. To do so, the chapter first provides a foundational stone of the historical development

of the corporate judiciary in Saudi Arabia. Second, the chapter differentiates between the role of the judiciary in enforcement into two subsections: public enforcement and private enforcement. Under each category, the chapter examines the nature of the judicial intervention ex post and accentuates the protective aspects of these interventions.

Part I. The Development of the Corporate Judiciary in Saudi Arabia

Overview

The Saudi judiciary is a dual judicial system and thus divided into two kinds of courts,⁶⁹² Sharia courts (akin to civil courts) and administrative courts, each of which has its judicial hierarchy, including, subject-specific courts,⁶⁹³ multiple appellate courts, and a supreme court resting at the top. The term “corporate judiciary” is coined here to embody every competent court that has jurisdiction to adjudicate corporation-related and shareholder-related disputes. While there are no corporation-specific courts, throughout the history disputes arising out of the corporations have been ruled on in specialized tribunals, including the so-called commercial circuits and some quasi-judicial committees.⁶⁹⁴

After the issuance of the Saudi Companies Law of 2015 alongside massive changes dictated by the Vision 2030,⁶⁹⁵ the Saudi corporate judiciary underwent a transformational change aiming at high efficiency and rapidity. Although a comprehensive discussion of the Saudi framework of

⁶⁹² The duality of the Saudi judiciary was copied from the Egyptian system, which was inherited at first place from France, the origin of dual legal system. *See generally* Almajid, at 177; and Maren Hanson, *The Influence of French Law on the Legal Development of Saudi Arabia*, 2 ARAB L.Q. 272, 291(1987) (explaining how the French legal system found its way into the Middle East and thus the Kingdom of Saudi Arabia).

⁶⁹³ *See* Article 9 (3) of the Judicature Law of 2007.

⁶⁹⁴ An Example of quasi-judicial committees is the Committee for Resolution of Securities’ Disputes, which adjudicates security-related conflicts and violations, including shares of joint-stock corporation. For further information, see Bandar O. Alrasheed, *Corporate Governance of The Saudi Arabian Publicly Traded Companies: an Appraisal and Proposals for Improvement*, 196–199 (2014).

⁶⁹⁵ *See supra* Chapter Two, Part I, A (4).

the judiciary falls beyond the scope of the research, to understand the development of the Saudi corporate judiciary and its complexity, a brief show of the history of its development is of necessity. Therefore, a distinction is made here between the development of corporate judiciary before 2015 and after 2015.

A. The Corporate Judiciary before 2015

After the promulgation of the first Companies Law in 1965, the Law, similar to previously-enacted laws,⁶⁹⁶ faced fierce oppositions from Sharia-court judges and religious jurists at that time.⁶⁹⁷ In other words, the courts declined to apply and implement any of these “positive laws”, for the implementations of these laws would run afoul of Sharia, the opponents alleged.⁶⁹⁸ One example of their rejections was the refusal of the limited liability feature of some enterprises, including the joint-stock corporations and the limited liability companies.⁶⁹⁹

⁶⁹⁶ E.g., The Law of Commercial Court.

⁶⁹⁷ This comes as a natural result of the different Islamic schools of thought and how a jurist interprets Sharia texts. See, e.g., H. S. Shaaban, *Commercial Transactions in the Middle East: What Law Governs*, 31 LAW & POL’Y INT’L BUS. 157, 172 (1999).

⁶⁹⁸ E.g., Hossein Esmaeili, *On a Slow Boat towards the Rule of Law: The Nature of Law in the Saudi Arabia Legal System*, 26 ARIZ. J. INT’L & COMP. L. 1, 48 (2009) (highlighting the effects of religious leaders on the progress and reform in the country alongside social factors).

⁶⁹⁹ Cf. CHIBLI MALLAT, INTRODUCTION TO MIDDLE EASTERN LAW 329 (Oxford Univ. Press 2009) (documenting the refusal of limited liability feature:

“Yet neither law nor the business world has fully digested the separation, and some courts are reluctant to stop at the company’s assets in case of unpaid debt. This phenomenon is difficult to document in the absence of systematic law reporting, particularly in the Gulf states, where the size and importance of the companies in the era of oil is evident. Legal practice, as far as can be ascertained from lawyers and businessmen, confirms the difficulty, in countries where the persona of the directors and major shareholders of the companies is paramount, in limiting liability to the capital and assets of the company, without touching upon the personal property of the decisive actors in such business ventures.”)

However, see Bandar O. Alrasheed, *Corporate Governance of The Saudi Arabian Publicly Traded Companies: an Appraisal and Proposals for Improvement*, 73 (2014) (Unpublished SJD dissertation, University of Pittsburgh) (on file with the author) (“[R]ecent developments in Islamic jurisprudence approve compatibility of limited liability with *Sharia*.”)

The rejection of implementing positive laws (including the Companies Law) resulted in the creation of another judicial body consisting of several quasi-judicial committees and circuits, to each of which the judicial power was delegated by law to adjudicate disputes pertaining to positive laws.⁷⁰⁰ Therefore, this approach to overcome such a rebuff led to the formation of commercial circuits within the hierarchy of the administrative judiciary.⁷⁰¹ The commercial circuits would review and rule on disputes pertaining to the Law of Commercial Court and Companies Law. These disputes included corporation-related lawsuits, shareholder-related conflicts, brokerage-related claims, commercial transport complaints, bankruptcy cases, and other commerce-related disputes.

The commercial circuits showed great deference to the Companies Law of 1965. They would rely on its articles in solving lawsuits and exercise their gap-filling power in the absence of a written rule according to the common law (principles and rules derived from Sharia).⁷⁰²

⁷⁰⁰ Nowadays, there are circa 75 quasi-judicial committees ruling on different sorts of disputes. Each enjoys judicial jurisdiction that helps it to perform its duties in resolving and ruling on disputes of certain types. Some of these committees' power even include the power to impose monetary penalties or imprison violators.

⁷⁰¹ Cf. Ayoub M. Al-Jarbou, *Judicial Independence: Case Study of Saudi Arabia*, 19 ARAB L.Q. 5, 27 (2004) ("The Board has been authorized since 1987 to decide most of the commercial disputes which used to be under the authority of what was the Commercial Dispute Committees. It has been granted this authority by Royal Decree number m/63 on 26/11/1407AH (1987)."); Abdullah F. Ansary, *A Brief Overview of the Saudi Arabian Legal System*, GLOBALEX (2008) [http://www.nyulawglobal.org/globalex/Saudi_Arabia.html] ("Although Article 1 [of the Law of the Board of Greivance of 1982] states that the Board is an independent administrative judicial board, it has been authorized to decide cases and disputes to which the administration is not a party. It is authorized to temporarily adjudicate criminal, and commercial disputes . . .")

⁷⁰² See generally George Sayen, *Arbitration, Conciliation, and the Islamic Legal Tradition in Saudi Arabia*, 9 U. PA. J. INT'L BUS. L. 211, 213 (1987) ("The statutes are intended to supplement rather than modify the Sharia, and are at least theoretically subordinate to it in cases of conflict."); Ahmed A. Al-Ghadyan, *The Judiciary in Saudi Arabia*, 13 ARAB L.Q. 235, 235 (1998) ("Islamic Sharia is the law applicable to all judicial matters. It should be applied according to the Hanbali school of jurisprudence."); Faisal M. Al-Fadhel, *Legislative Drafting and Law-Making Practices and Procedures under Saudi Arabian Law: A Brief Overview*, 1 I.J.L.D.L.R. 95, 98 (2012) ("The primary sources of Sharia are the *Quran* [the holy book of Islam] and the *Sunnah* [a collection of the sayings of Prophet Muhammad and examples of his behavior] and there exist [sis] a closed number of other secondary sources of Sharia or

In 2007, a new judicature act was enacted,⁷⁰³ launching a new era for the Saudi judiciary. One of the prominent aspects of this law was the adoption of subject-matter jurisdiction. It establishes that Sharia first instances are to be restructured into subject-matter jurisdiction of five courts: family courts, commercial courts, labor courts, criminal courts, and general courts that hear all complaints that do not fall within any of the subject-matter jurisdictions.⁷⁰⁴ This should have ended the longstanding divorce between the commercial circuits and the Sharia courts. However, the status of these circuits continued as it had been until 2015. One of the most side effects of this messy divorce was the confusion about which court would have jurisdiction over a complaint. That resulted in lengthy trials and countless cases dismissed due to the lack of jurisdiction by both courts.

B. The Corporate Judiciary after 2015

Enacting the Companies Law of 2015 alongside far-reaching changes brought by the successive government called for the transformation of the existing commercial circuits into commercial courts as the Judicature Law stipulates.⁷⁰⁵ Two years later (September 2017), the Ministry of Justice inaugurated its commercial lower courts. It was the end of an era of confusion for the public and of withholding of the Judicature Law.

This turning point in the commercial judiciary is believed to effect changes on various levels. Having specialized courts for only commercial disputes implies a greater capacity of specialized

methods for adducing appropriate normative behaviour in response to new incidents and unregulated circumstances.”)

⁷⁰³ This Law was enacted by a royal decree No. M/78, in 2007. It was part of a bigger project aiming at comprehensive reforming of the judiciary (both Sharia and administrative courts) in Saudi Arabia by the former king, King Abdullah Al Saud, who allocated nearly 2 billion U.S. dollar for this shake-up project.

⁷⁰⁴ See Article 9 (3) of the Judicature Law of 2007.

⁷⁰⁵ See Article 9 (3) of the Judicature Law of 2007.

judges designated to these disputes, which result in shortening the span of litigations.⁷⁰⁶ Another ramification that has been already observed is the periodical publication of the courts' rulings. Since the inception of the commercial courts, the rulings have been published on the Ministry's website on a monthly basis.⁷⁰⁷ Needless to say that such publications make these courts more predictable and thus reliable,⁷⁰⁸ which positively contributes to the confidence of litigants, especially foreign ones.⁷⁰⁹

Part II. Public Enforcement

Public enforcement connotes state authorities that are vested with powers to uphold the Companies Law of 2015 and prosecute the lawbreakers. In the Saudi close corporation's context, public enforcers include the Public Prosecution and the Ministry of Commerce and Investment.⁷¹⁰ This part explores the role of the corporate judiciary in lawsuits brought by public enforcers, the Public Prosecution alongside the Ministry of Commerce and Investment. To that end, the parameters of powers of each authority are of significance to determine within which authority an illegal activity falls, and what forms of intervention each authority may seek.

⁷⁰⁶ *Contra* Youseif A. Alzahrani, *Rights of Shareholders under Saudi Company Law 1965*, 21–22 (2013) (Unpublished Ph.D. dissertation, Brunel University) (on file with the author) (arguing that the judicial system is still suffering from shortage of judges in courts in comparison with the number of lawsuits filed each year in Saudi courts).

⁷⁰⁷ See the Ministry of Justice website at <https://www.moj.gov.sa/en/Pages/default.aspx>.

⁷⁰⁸ Note that these rulings do not constitute precedents, but rather they provide common understanding of how a judge may rule in similar circumstances. See generally David J. Karl, *Islamic Law in Saudi Arabia: What Foreign Attorney's Should Know*, 25 GEO. WASH. J. INT'L L. & ECON. 131, 149–150 (1991) (“[J]ust because a judge, *qadi*, issued a particular ruling in the past does not mean that he or any other judge will rule the same way in the future, even if presented with an identical set of facts.”)

⁷⁰⁹ E.g., David J. Karl, *Islamic Law in Saudi Arabia: What Foreign Attorney's Should Know*, 25 GEO. WASH. J. INT'L L. & ECON. 131, 169 (1991) (there are indications that Saudi Arabia's legal system may become increasingly hospitable toward international commerce, and increasingly aligned with Western doctrines.”).

⁷¹⁰ In the context of public corporations, the squad of public enforcers includes (alongside the Public Prosecution and the Ministry of Commerce and Investment) the Capital Market Authority and the Committee For Resolution of Securities Disputes.

A. The Public Prosecution

1. Powers

The Law delegates to the Public Prosecution the power to investigate and press charges against offenders committing any of the illegal activities itemized in Articles 211 and 212.⁷¹¹ These powers constitute ex post intervention that may take different forms, including pecuniary interventions (e.g., fines), non-pecuniary intervention (e.g., incarceration), or both.⁷¹² These interventions, nevertheless, are subject to the judicial review that must find the defendant to be guilty of violating the Law and thus deserving of the punishment.⁷¹³

Furthermore, the Law goes above and beyond by allowing the Public Prosecution to prosecute the corporation itself in case the prosecution of the real offender is unavailable for any reason.⁷¹⁴ For example, if the perpetrator perishes, the Public Prosecution may seek imposition of monetary fines upon the corporation instead.

2. Scope of Powers

The Law restricts the investigative and prosecutorial powers of the Public Prosecution to the offenses enumerated in Articles 211 and 212. These articles are crafted in a way to be all-encompassing, leaving no room for maneuver. Such offenses include providing misleading information,⁷¹⁵ willful omission of material facts,⁷¹⁶ misuse of voting right to the detriment of the

⁷¹¹ Article 215.

⁷¹² Articles 211 & 212.

⁷¹³ On the other hand, the Ministry of Commerce and Investment may impose monetary penalties for violations stipulated in Article 213 without a judgment, as explained in the subsequent subsection.

⁷¹⁴ Article 217.

⁷¹⁵ Article 211 (a)

⁷¹⁶ *Id.*

corporation or gaining personal benefits,⁷¹⁷ failure to call for a shareholder meeting (where a duty to call exists),⁷¹⁸ divulgence of corporate secrets,⁷¹⁹ and the mishandling of corporate funds.⁷²⁰

Theoretically, the language of both Articles grants the Public Prosecution broad discretion over the interpretation of what actions constitute an offense by law. For example, the Law criminalizes the use of power by directors and officers in a way detrimental to the corporation's interests, either by realizing personal benefits or extracting direct or indirect gains from deals the corporation executes by virtue of that power.⁷²¹ This text provides the authority with a great deal of latitude to make sure that such the offender may not escape justice, while it also acts as a deterrence that the prejudiced people may favor avoiding a suspicious business activity instead of being criminally accountable for it.⁷²²

3. Penalties

The intervention by the public Prosecution may take different forms, including pecuniary interventions (e.g., fines), and non-pecuniary interventions (e.g., incarceration). Either of these forms of intervention, the Public Prosecution is to obtain a judgment finding the defendant guilty of violating the Law and thus deserving of the punishment. The Law empowers the authority to seek two kinds of punishment premised on how drastic an illegal activity is. For instance, the Law enables the Public Prosecution to seek (for acts stipulated in Article 211) imposition of monetary fines not exceeding 5 million Saudi riyals (1,33 million U.S. dollars), or imprisonment of the

⁷¹⁷ Article 211 (c)

⁷¹⁸ Article 211 (d)

⁷¹⁹ Article 212 (b)

⁷²⁰ Article 211 (b)

⁷²¹ Article 211 (c)

⁷²² Practically, I was not able to locate a case brought by the Public Prosecution against a close corporation or a shareholder thereof. In the context of public corporations, nevertheless, the Public Prosecution regularly brings lawsuits against offenders of the Companies Law or capital-market regulations based on referral by the Capital Market Authority as the Competent Authority of regulating and supervising public corporations.

offender not exceeding five years, or both. These acts include the mistreatment of corporate funds, the manipulation of corporate books and financial statements, and the engagement in self-interest dealings.⁷²³ For less drastic misconduct (Article 212), the Public Prosecution may seek imposition of fines not exceeding 1 million Saudi riyals (266,666 U.S. dollars) or a maximum of one-year imprisonment, or both.⁷²⁴ To add a layer of deterrence, the Law doubles the punishment in both Articles in case of recidivism. Repeat and persistent offenders committing the exact violation may be subject to a doubled punishment.⁷²⁵

That being said, the corporate judiciary's role is of paramount importance as it assesses the charges and ensures that whatever the form of intervention the authority is seeking is proportional to the alleged violation or misconduct, subjecting the enforcement by state authority to the judicial review of its statutory discretion.⁷²⁶

B. The Ministry of Commerce and Investment ⁷²⁷

1. Powers

The Ministry assumes a leading role in the enforcement of the Law. As the Law assigns an array of powers to the competent authority of close corporations, these powers can divide the role of the Ministry into supervisory, regulatory, and disciplinary roles. These roles jointly strengthen

⁷²³ Article 211.

⁷²⁴ In both circumstances, punishment in accordance with the Companies Law does not negate other punishment in any law. For instance, if a director utilizes his voting power to the detriment of the corporation as a result of a bribe he receives, that director may be prosecuted for misuse of her voting power according to Article 211 (c) of the Companies Law, and she may be prosecuted for bribery according to the Law of Anti-Bribery, if applicable.

⁷²⁵ To recognize an offender as a recidivist, three conditions are to be met. First, the offender commits the same violation, for which, second, a final judgment is made against her. Third, the second violation transpires within three years from the date of the sentence. *See* Article 214.

⁷²⁶ Article 223 stipulates that “[t]he competent judicial authority [commercial courts] shall decide all civil and penal lawsuits and disputes arising from the implementation of the provisions of the Law, and shall impose prescribed penalties.”

⁷²⁷ Hereinafter “the Ministry”.

the enforcement of Law by the non-judicial authority since most of the actions the Ministry may take do not involve the review of the judiciary or its approval, making the Ministry a more responsive enforcer to the needs of the corporations (and shareholders) and the to the violations of the Law.⁷²⁸

2. Scope of Powers

According to the Law, the Ministry assumes various tasks. First, it is incumbent upon the Ministry to watch and superintend the operating business enterprises—including the close corporations. To that end, the Ministry enjoys the right to inspect the corporations, review their books, and request their records (supervisory role).⁷²⁹ This includes the chairperson's duties to notify the Ministry about any changes or updates in the corporation's constitutional documents (e.g., change in the bylaws or shareholders), and to submit the financial statements and the resolutions decided by the shareholder assembly.⁷³⁰ The role goes farther to permit the Ministry to deputize some of its personnel to inspect the corporation and its accounts alongside attending its shareholder assembly, if necessary.⁷³¹ On the other hand, the officers and directors of the corporation are to allow the Ministry's officials to access the corporation's books and records and provide them with all documents they demand.⁷³² This role lets the Ministry ensure the conformity of the corporations with all applicable laws and regulations by keeping an eye on them.

Second, the Law empowers the Ministry to take whatever deemed necessary for the implementation of and compliance with the Law (regulatory role).⁷³³ Examples of the Ministry's

⁷²⁸ *Infra* Chapter 5, Part II, B (3).

⁷²⁹ Article 220.

⁷³⁰ *Supra* Chapter Three, Part III, E.

⁷³¹ Article 220.

⁷³² Article 221.

⁷³³ Article 225 (2).

exercising this power include the regulation of online voting,⁷³⁴ and the issuance of the guiding templates and forms for the incorporation of each enterprise.⁷³⁵ In an evaluation of this role, nevertheless, it may seem to be a double-edged weapon. It is true that such a role allows the Ministry to respond more effectively to rapid changes, while it may adversely affect the stability and predictability of the market, and it becomes a source of demagnetizing the market and turns off foreign investors.

As the Ministry polices the corporate arena in Saudi Arabia, it also enjoys the power to penalizes wrongdoers within its jurisdiction (disciplinary role). Article 213 stipulates various violations that fall within the Ministry's jurisdiction. Such violations include depriving the shareholder of the right to attend shareholder assembly and vote,⁷³⁶ distributing dividends in violation with the corporation's constitutional documents or shareholder-assembly resolutions,⁷³⁷ obtaining a loan from the corporation in violation of the Law,⁷³⁸ obtaining benefits to vote in a certain way,⁷³⁹ and blocking a shareholder from accessing the books and the records of the corporation.⁷⁴⁰

3. Penalties

The statutory jurisdiction of the Ministry to penalize wrongdoers brings a further dimension to the discussion of protecting the minority shareholders. Unlike penalties imposed by the Public Prosecution (where the judiciary has to approve these penalties),⁷⁴¹ the Law allows the Ministry to

⁷³⁴ *Supra* Chapter Three, Part II, A, 1(d).

⁷³⁵ *Supra* Chapter Two, Part I, B (4).

⁷³⁶ Article 213 (f).

⁷³⁷ Article 213 (a).

⁷³⁸ *Supra* Chapter Three, Part III, E.

⁷³⁹ Article 213 (g).

⁷⁴⁰ Article (j).

⁷⁴¹ *Supra* Chapter Five, Part II, A (3).

impose monetary fines on lawbreakers without the need to a court judgment.⁷⁴² As soon as the Ministry comes across an offense stipulated in Article 213, or is notified about it by other shareholders, the Ministry may impose a fine—up to 500,000 Saudi riyals (\$133,333).⁷⁴³ As a matter of justice, the Law allows fined individuals to appeal before the commercial court.⁷⁴⁴

The nature of the violations prescribed in Article 213 underscores the importance of this role in protecting the minority shareholders. Most of these violations constitute oppressive conduct and opportunistic behaviors committed by dominant shareholders that need immediate attention in order for the harmed party to exercise their statutory rights. Therefore, asserting this role to the Ministry to intervene and immediately penalize wrongdoers ensures the protection for the minority shareholders the Law promotes. It allows the oppressed shareholders to seek an immediate intervention by the Ministry to retrieve their statutory rights, without bearing the cost of lengthy lawsuits.⁷⁴⁵

C. Overall Assessment

Given the crisp description above, it is critical to point out to a number of conclusions stemming from a comparative view of both laws. First of all, the Law comes to reset the corporate arena in terms of the authorities in charge of regulating its actors. The ambiguity of authorities no longer exists, but rather it is replaced with a comprehensive framework that specifies every enforcer, and the powers to which each enforcer is entitled. The claim is that the introduction of the Public Prosecution as a competent authority of violations the Law comes to criminalize—for

⁷⁴² Article 216.

⁷⁴³ Article 213. In case of recidivism, see *supra* note 725.

⁷⁴⁴ Article 216.

⁷⁴⁵ Whether the disciplinary role of the Ministry is effective on the ground is an interesting yet empirical question. Given the newness of the Law and the absence of published data about such fines, it is unlikely to reach reflective assessment of the Law in this regard. Nevertheless, the employment of logic and imagination suggests that knowing the Ministry's power of immediate disciplining should suffice to act as a deterrence to would-be wrongdoers unless otherwise proven.

the first time⁷⁴⁶— and the roles of the Ministry craft an institutionalized environment where the shareholder’s rights matter. Moreover, the enlargement of the Ministry’s role is of paramount importance as it oversees the corporate actors in on hand and punishes the violating ones on the other. These inspective and disciplinary powers granted to a responsive institution ensure the growth of a rights-respectful business environment.

Most importantly, the judicial jurisdiction over the prosecutorial and ministerial authorities is an integral part of a well-institutionalized market where the courts keep other institutions in check. The nature of the court’s intervention aims at the fairness of the machinery of public enforcement. The accused lawbreakers and fined violators have the right to make their cases and defend themselves before an impartial institution that guarantees the just exercise of power by the governmental and prosecutorial institutions.⁷⁴⁷ The judiciary has to decide whether the accused is criminal (in case of the cases brought by the Public Prosecution) or to hear the appeal of a fined person (in case of the pecuniary penalties imposed by the Ministry).

Finally, the absence of data and the recency of the Law make it difficult to gauge the efficacy of public enforcement and the protection with which it may provide the minority shareholders. Nevertheless, the existing structure of the public enforcement should theoretically reinforce “legal mobilization”⁷⁴⁸ enabling the affected shareholders to have faith in the competency of these

⁷⁴⁶ Although no lawsuit has been spotted in regard with close corporations, the Public Prosecution—in cooperation with the Public Market Authority— has an indispensable role in regard with public-corporation-related crimes. Evidently, the Public Market Authority’s website includes a range of criminal cases brought by the Public Prosecution and adjudicated by the Committee for the Resolution of Securities Disputes.

⁷⁴⁷ Accord Ayoub M. Al-Jarbou, *Judicial Independence: Case Study of Saudi Arabia*, 19 ARAB L.Q. 5, 6 (2004) (claiming that in sheltering the rule of law, “judges become powerful players in maintaining the submission of the government to the law: they prevent potentially arbitrary acts of the government and its instrumentalities”).

⁷⁴⁸ Notwithstanding the difference between subject matters, the term legal mobilization is used by Charles Epp to refer to all resources available for individuals to realize the effects a bill of rights brings about. Such resources include governmental financing, rights-advocacy organizations, and the access to lawyers

institutions to redress violations of the Law, and thus seek their interventions to rectify oppression and retrieve their statutory rights. Reliable courts alongside well-established institutions (i.e., the Public Prosecution and the Ministry of Commerce and Investment) with well-fashioned roles ought to mobilize support for the protection of minority shareholders.

Part III. Private Enforcement

Private enforcement refers to litigations triggered by an individual shareholder. Under certain circumstances, violations of the Law do not cause harm to the corporation (and thus shareholders as a whole), but rather they harm a particular shareholder, who then seeks the judicial intervention to retrieve a statutory right, to rectify harm or oppression, to be remedied or both. That being said, this Part excludes the private enforcement of the Law brought on the corporation's behalf by means of derivative actions;⁷⁴⁹ instead, it focuses on the direct action as a corrective instrument that responds to the close corporation's issues.⁷⁵⁰ This Part investigates the status quo of the direct action, and it scrutinizes what remedies the shareholder may demand under this action. Finally, it casts the light on the stance of the Saudi judiciary in regard to other remedies and actions the Law does not stipulate, and on the availability of these remedies.

A. Direct Action

1. The Nature of Shareholder Direct Action

The close corporation's issues are frequently associated with direct personal harm to certain shareholders (i.e., minority shareholders). Therefore, the shareholder may bring a direct action

and the structure of legal profession. For in-depth look into this argument, see Charles R. Epp, *Do Bills of Rights Matter? The Canadian Charter of Rights and Freedoms*, 90(4) AM. POT. SCT. REV. 765, 765 (1996).

⁷⁴⁹ See *supra* Chapter 4, Part III, F.

⁷⁵⁰ *Supra* Chapter 1, Part II.

against the corporation, its directors, officers, or a dominant shareholder to redress the harm.⁷⁵¹ However, it is paramount to differentiate between two causes for personal harm. First, the shareholder may incur harm as a result of the corporation's violating the Law or obstructing his statutory right. Second, the shareholder may be affected as a result of a legitimate corporate action (e.g., refusal to pay dividends); the recognition of the latter harm may be traced to the judicial understanding of the special nature of the close corporation and its inherent problems, as it is the case in several U.S. states.

In Saudi Arabia, however, the Saudi courts have not yet considered the special characteristics of the close corporations, which meshes with the legislative approach that also does not distinguish between close and public corporations. Nonetheless, this may not negate the existence of direct action on such harm. In fact, one of the judicially-implemented maxim rooted in Sharia (common law) is that *Al Darār Yuzal* (injury must be removed).⁷⁵² While there is no ruling about the issues at hand, one may imagine the shareholder bringing a direct action predicated upon this tort doctrine as it is a core maxim upon which rulings in different subject matters have been established.

That being said and given the Islamic theme of the country, this maxim should be the underpinnings for the statutory cause of action for shareholders in close corporations. The failure to recognize such an action raises grave concern about the shareholder's standing to fight against oppressive, opportunistic yet legitimate conduct. Such failure stems from the absence of both statutory and judicial division between close and public corporations.⁷⁵³ A discontented

⁷⁵¹ Accord Wade H. III Watson; J. Bertram Levy, *The Development of the Shareholder's Direct Action Damage Remedy*, 28 GA. ST. B. J. 195, 195–96 (1992) (tracing the origin of the shareholder's direct action to the unique nature of close corporations).

⁷⁵² *Al Darar* means harm, while *Yuzal* means removed. It is of the comprehensive Islamic maxims. See generally Mohammad Hashim Kamali, *Legal Maxims and Other Genres of Literature in Islamic Jurisprudence*, 20 ARAB L.Q. 77, 85–87 (2006) (elaborating on the concept of *Darar* (harm) in Islam and what other maxims raising out of this concept).

⁷⁵³

shareholder of the public corporation has the right to exit the corporation at any time for fair value, while a frustrated shareholder in the close corporation (like Saad) finds it difficult to liquidate his interests without the minority discount. Therefore, the statutory cause of action for the shareholders in close corporations should be an indispensable aspect of every statutory corporate governance for non-listed corporations.

2. Infringement of the Law as Cause of Action

Returning to the motivating hypothetical, Saad has been, inter alia, deprived of a fundamental right enshrined in the Law, the right to access the corporation's books and records. As demystified in the preceding chapter, the Law entitles the shareholders to a number of sacred rights to ensure that the shareholders play their roles without the burden to contract for these rights.⁷⁵⁴ If these rights are violated, it is incumbent upon the corporate judiciary to remedy the complaining shareholder.

Furthermore, the judicial remedy may vary based on the nature of the violation, so the courts have wide discretion to select what remedy is best to apply as a matter of fact. In Saad's situation, for instance, the commercial court may order the corporation to allow the complaining shareholder to access its books and records. It may go farther to nullify the corporate decision if the complaining shareholder establishes that the corporation's denying him access led to a misinformed vote.⁷⁵⁵ Evidently, the corporate judiciary has always shown willingness to uphold the statutory shareholder rights earnestly.⁷⁵⁶

⁷⁵⁴ See *supra* Chapter 4, Part II.

⁷⁵⁵ Article 110 establishes, inter alia, the shareholder's right to request nullification of violating corporate decisions.

⁷⁵⁶ E.g., Case No. 597/ 2/ Q [٢/٥٩٧], Jeddah Commercial Court, Second Circuit (H 1438 [corresponding to 2017]). [on file with the author].

Similar to the right to access the corporate books and records, the corporate judiciary may order the corporation to enable shareholders to exercise other statutory rights, such the right to attend and vote in shareholder meetings.⁷⁵⁷ The obstruction of these rights permits the corporate judiciary not only to invalidate whatever decisions resulted from those meetings but also to penalize the obstructing individual. All in all, the shareholder's action to request the judicial enforcement of the statutory rights when infringed ensures the implementation of the shareholder's roles according to the Law on the one hand and fosters the business environment abiding by laws and regulations on the other.

3. Oppression as Cause of Action

The oppression concept as defined by several U.S. states is absent from the Saudi corporate laws. As explained earlier, the oppression is oftentimes a result of either a squeeze-out action forcing the minority shareholders to exit the corporation for unfair value or a freeze-out technique employed to deprive the minority shareholders of returns (salaries or dividends) on their investments (as in the case of Saad). The enfeebled shareholders seek out equitable reliefs for the oppressive conduct. Nevertheless, in the absence of the statutory and judicial definition for oppression, there is much ambiguity in terms of when legitimate actions taken by the controlling shareholders would constitute a form of oppression in Saudi courts. In the hypothetical, Saad is deprived of all financial returns on his investments. Whether such denial is by the book, the nature of the close corporation involves the judicial lens to look holistically at such issues in their context.

Notwithstanding the dire need for the statutory recognition of the special nature of the close corporations, the corporate judiciary should develop the concept of the oppression as a judicially-created doctrine to protect the minority shareholders. One solid foundation upon which this

⁷⁵⁷ See *supra* Chapter 4, Part II, 1 & 2.

doctrine should be tailored is the theory of right abuse alongside the corresponding Islamic maxim of *Al Darār Yuzal* (harm must be removed).⁷⁵⁸

Another robust basis for oppression as a cause of action is the statutory principle of shareholder equality. The appropriation of corporate profits by some shareholders in the form of salaries and rewards runs afoul of the fundamental equality doctrine the Law underscores in multiple stances.⁷⁵⁹ Furthermore, the equality premise finds its strength in the fact that it is a peremptory law that may not be contracted out or derogated by any means of agreement. Therefore, it is true that the majority rules the corporation, yet such control has to be consistent with the equality and fairness principles among shareholders.⁷⁶⁰ Otherwise, biased decisions favoring a group of shareholders over others will be challenged in a court of law and violating officers may face harsh penalties.⁷⁶¹

B. Judicial Remedies

Asserting the shareholder's right to bring a direct or derivative action against the corporation or its management is a significant step to effectuate the judicial intervention ex post, to remedy injured shareholders, and upholding the Law. In Saudi Arabia, the judicial intervention in oppression-related claims may be in the form of invalidation of the corporate resolution that results

⁷⁵⁸ For further information on the theory of right abuse, see Michael Byers, *Abuse of Rights: An Old Principle, A New Age*, 47 MCGILL L.J. 389, 434 (2002); Joseph M. Perillo, *Abuse of Rights: A Pervasive Legal Concept*, 27 PAC. L. J. 37, 98 (1995).

⁷⁵⁹ See, e.g., article 110 asserts the equality of rights and obligations rendered by shares. Article 111 requires that—in case of the redemption of share—redemption be made by drawing or another way that guarantees fairness among all shareholders.

⁷⁶⁰ It is important to note that there are two sorts of equality, equality of shares and equality of shareholders. What the Law mandates is the equality of shares, which can be accentuated by one-share-one-vote rule. This principle of equality differs from the equal treatment of shareholders, which would be, if applied, inconsistent with principles and view of western economy of corporations (e.g., majority rules). See Nicola De Luca, *Unequal Treatment and Shareholders' Welfare Growth: Fairness v. Precise Equality*, 34 DEL. J. CORP. L. 853, 894–895 (2009).

⁷⁶¹ *Contra* Nicola De Luca, *Unequal Treatment and Shareholders' Welfare Growth: Fairness v. Precise Equality*, 34 DEL. J. CORP. L. 853, 919–920 (2009) (advocating for the permission of unequal treatment so long as it accomplishes economic results and claiming that “strong equal treatment rule does not avoid all oppression of minorities).

in oppressive conduct, court-ordered payment of dividends, or—in rare circumstances— the dissolution of the corporation. That being said, a court-ordered buy-out remedy, which is prevalent in some jurisdictions, is unavailable in Saudi courts due to its incompatibility with Sharia. In principle, the shareholder may not be forced to sell her shares or obligated to purchase another's shares.⁷⁶²

1. Judicial Dissolution

Unlike voluntary dissolution by a vote of shareholders, the Law grant courts the power to liquidate and dissolve the corporation against the will of its shareholders or management (compulsory liquidation).⁷⁶³ Since this remedy involves the death of the corporate legal person, commercial judges have held the request of the judicial dissolution to stringent standards. These standards include the prosperity of the corporation, the size of shareholding under oppression,⁷⁶⁴ and the availability of other remedies to the oppressed shareholders. These standards have been utilized by the courts worldwide to mitigate not only the economic but also the noneconomic losses and to balance the shareholders' reasonable expectations.⁷⁶⁵

Returning to the hypothetical discussed above in which Saad (oppressed minority shareholder) thinks about requesting judicial dissolution, the commercial judge would be likely to dismiss

⁷⁶² The rationale behind the nullification of mandatory buyouts is that at least one party to the transaction is bound to the deal by force and not by his free will, which makes the transaction lack the fundamental condition of voluntary affirmation and acceptance.

⁷⁶³ Article 205 (2).

⁷⁶⁴ Unlike other jurisdictions (i.e., Nevada, Ohio and Connecticut), the Saudi Law does not impose a percentage as a prerequisite to initiate a judicial dissolution, which, I believe, offers greater protection for minority shareholders regardless of how many shares a complaining shareholder has. Cf. Harry J. Haynsworth, *The Effectiveness of Involuntary Dissolution Suits as a Remedy for Close Corporation Dissension*, 35 CLEV. ST. L. REV. 25, 40 (1987).

⁷⁶⁵ Steven C. Bahls, *Resolving Shareholder Dissension: Selection of the Appropriate Equitable Remedy*, 15 J. CORP. L. 285, 287 (1990) (likening dissension in close corporations to dissension in a marriage as in both situations “complex emotional and financial relationships exist that courts cannot easily dissolve without losses.”)

Saad's request for the judicial dissolution, given the corporation's prosperity and profitability, or at least would not find the judicial dissolution to be the most appropriate, equitable remedy. The prosperity and profitability factors influence the availability to grant the shareholder's request to dissolve the lucrative business. However, assuming that Saad and his brother acted as a group, the judicial dissolution may be justified on the grounds of deadlock, at least in theory.⁷⁶⁶

All in all, even though the judicial dissolution is a statutory remedy that is available to the dissenting shareholders, the courts have absolute discretion whether to grant such a relief. Except in rare circumstances (i.e., deadlocks), courts may find compulsory dissolutions inequitable, and thus grants another, yet less aggressive remedy.

2. Invalidation of Corporate Actions

Another statutory relief the Law empowers the judiciary to grant is to invalidate the corporate action or resolution the court determines to be against the Law. In several stances of the Law, the Saudi legislature gives the power to the judicial authority to invalidate corporate actions, whether in the form of a contract, resolution, or provision. For example, Article 99 stipulates the shareholder's right to request the invalidation of an assembly resolution running afoul of the corporation's constitutional documents.⁷⁶⁷ Another example is that if the board member fails to comply with the disclosure requirements concerning a related-party transaction, the Law allows the corporation or any stakeholder to petition the court to invalidate the suspicious contract.

⁷⁶⁶ Harry J. Haynsworth, *The Effectiveness of Involuntary Dissolution Suits as a Remedy for Close Corporation Dissension*, 35 CLEV. ST. L. REV. 25, 34 (1987) (supporting the judicial dissolution of successful corporation on the grounds of deadlock instead of limiting this remedy to only corporations on the brink of insolvency).

⁷⁶⁷ As a matter of statute of limitation, the Law dismisses invalidation requests after the lapse of one year from the issuance of the resolution. *See* Article 99.

3. Court-Ordered Payment of Dividends

Another alternative remedy the court may order—instead of dissolving the corporation—is to order the corporation to pay dividends.⁷⁶⁸ As explained earlier, one issue minority shareholders in close corporations confront is that the dominant shareholders secure returns on their investments in the corporation in forms of salaries and rewards and thus withhold the distribution of dividends, leaving the minority with no returns on their capital investments at all. Nevertheless, this remedy is not stipulated in the Law, but rather it is a judicially-created relief. The plaintiff (the minority shareholder) has to show that although the corporation gains profits, the management (i.e., the dominant shareholder) declines to distribute dividends, as in the motivating hypothetical.

The premise of this remedy can be traced to the central component of the statutory definition of the corporation, the sharing of profits and losses. If the corporation is making profits, yet—without proper justification—it denies some of its shareholders returns of their capital investments, the judge has the power to intervene to remedy the deprived shareholders. One drawback of this remedy, however, is that it is contingent upon how the judge construes and apply the Law and whether he is willing to make such an order. Given the fact that the Saudi judiciary is not precedent-oriented, the uncertainty to prevails in these claims may make shareholders reluctant to initiate them in the first place. In addition, the absence of this relief in the Law raises concern about its availability, whereas the concern should be whether the circumstances justify such a relief, as in the judicial dissolution.

⁷⁶⁸ In search for answers, I had an informal meeting with a senior judge at the Dammam Commercial Court, where I asked him several questions about the court's roles in some corporate instances, one of which was withholding dividends. He answered me confidently that in such cases the judge might order the corporation to distribute dividends despite the fact that such a power was not stipulated in the Law.

C. Overall Assessment

Thus far, the judicial role in the private enforcement cases may not be as well-defined and predictable as it should be. As per the Law, the court has undisputable powers to adjudicate cases where the subject is an infringement of the law that has caused harm to the plaintiff (i.e., the minority shareholder). It also asserts the court's power to remedy the complaining shareholders with the invalidation of corporate resolutions and actions or—in some harsh instances— with the dissolution of the corporation. In the absence of the statutory definition of oppression, however, it remains questionable whether a by-the-book action could be challenged in a court of law. Such recognition may only come from the statutory distinction between the public corporations (which the Law mainly focuses on regulating) and the close corporations. In addition, the Law fails to recognize other equitable remedies in cases of dissensions and clashes among shareholders, or at least to give the power to the judiciary to fashion equitable remedies on a case-by-case basis, which produces judicial uncertainty about how to resolve such issues. With no evidence to support the court-ordered payments, for example, there is no statutory or judicial ground upon which the shareholder may confidently bring a lawsuit against a legitimate corporate action.

Conclusion

In reviewing the judicial role in the public and private enforcement, one may conclude that as the commercial judiciary develops, the legislative body seems to overlook the supplementary and gap filling role the judicial body could play. The judicial branch should have statutory leeway to assess whether the shareholder has committed oppressive conduct and thus determine what remedy is equitable. The ambiguity of the judicial role regarding some corporate affairs generates unpredictability and uncertainty that adversely impact the corporate arena in the region. Prior to 2015, the chaos of the judiciary might have been understandable as the judicial jurisdiction was

disputed. Nevertheless, with the establishment of the commercial courts after 2015 and the appointment of specialized judges, the Law should broaden and entrust the judiciary with more powers to review and determine other disputed corporate affairs (e.g., director's compensation) instead of being limited to what the current Law asserts for it.

Concluding Chapter

*“The close corporation, long the orphan of corporate law.”*⁷⁶⁹

Part One: Summary

This research analyzed and examined the corporate governance structure offered by the Saudi Companies Law of 2015 as a device to protect the interests of the minority shareholders in close corporations. It began with an exploratory dive into the terminology of close corporations and minority shareholders, and it highlighted the most pervasive issues associated with this group of shareholders in this form of enterprises. Despite the tradability feature of shares, shares in close corporations lack access to a secondary market, which makes it difficult for shareholders to exit the corporation for fair value. Due to the small number of shareholders and the interpersonal relationships among them, furthermore, the shareholders often have the expectation that they would run the business and participate in its management, obviating the principle of majority rule. Therefore, once this expectation of the minority shareholder is frustrated, clashes and tensions among shareholders will arise, crippling the business and destroying the social and familial bonds. Another commonplace issue is the majority shareholder opportunism and oppression, which, as explained earlier, may be in the form of freeze-out or squeeze-out conduct. Three strategies have been implemented to overcome these issues and protect the minority shareholders from any oppressive or opportunistic conduct, either statutorily, judicially, or contractually.

Chapter two offered a general overview of the legal framework for corporations in the country and the structure of its ownership as it has played a vital role in shaping the current Law and favoring the shareholder-oriented corporate law. It is crucial to understand the backstage story of

⁷⁶⁹ Abram Chayes, *Madame Wagner and the Close Corporation*, 73 HARV. L. REV. 1532 (1960).

the corporation to evaluate the core subject of the research better and assess the circumstances that contributed to the contemporary form of corporate law and corporation.

Chapter three provided an in-depth analysis of the regulatory frame for close corporations, including its incorporation, management, and supervision. It comprehensively scrutinized the roles of the board directors and the shareholders under the Law, and it highlighted some criticism of some rules and possible ripple effects they would generate when they were applied. This chapter showcased the excessive use of mandatory rules to regulate the corporate affairs as a unique aspect of the Companies Law of 2015, which was the main reason why this research focused on the statutory protection of minority shareholders as a strategy to overcome the close corporations' issues.

Chapter four showcased how the implementation of several rules of the Law address some issues of the minority shareholders in close corporations. It started with a thorough explanation of the rights the Law asserts for the shareholders, and how certain statutory rights constitute a potent arsenal for the minority shareholders against the shareholder opportunism. Other rules of the Law come to protect the shareholder's expectations as these rules activate the shareholder's role in the management through the right to elect directors and the mandatory use of the cumulative voting system. Another statutory solution to the dilution of shareholder's interests is the strict quorum requirement for a share issuance by the Law along with the assertion of the preemptive rights for shareholders. To mitigate the side effects of the reality of share unmarketability, the research underscored several rules of the Law regulating the share transferability and ensuring that shares of joint-stock corporations are eventually tradeable even if they are subject to permissible restrictions. Also, other rules of the Law constitute protection for the minority shareholders as they

strictly regulate related-party transactions and corporate repurchases in the fight against the shareholder opportunism and reinforcement for corporate integrity and fairness.

As part of the argument with which the research began, chapter five analyzed the enforcement component of the Law and examined its efficiency to uphold the Law in one hand and penalize those who violate it on the other. It bisected the enforcement element into public and private, and it explained in length the authorities in charge of each sort of enforcement. Moreover, as part of the enforcement, the research shed light on the judicial role in implementing the Law and on the statutory remedies it has.

Part Two: Results and Recommendations

After a thorough investigation and analysis of the minority shareholders status under the Companies Law of 2015, the research concludes with several results and recommendations. It is wished that this study contributes to the ongoing debate over the protection for the minority shareholders in close corporations and propose—as one of the research questions—a host of legal measures to bring about the necessary improvements for the existing laws and regulations.

First of all, the minority shareholders of close corporations are susceptible to several risks caused by the exceptional nature of the close corporation. Unless the minority shareholders bargain for their protection, they are vulnerable to shareholder oppression and opportunism. The reality deficits, therefore, necessitate the establishment of a protective system of the minority shareholders' interests. The source of this protection may vary from laws and regulations or judicial rulings or a combination of both. It mainly depends on the sophistication of the legal system and the institutions of the country. As for Saudi Arabia, such protection is best to be derived from the statutory laws given the legal structure and the limited role of the judiciary to establish such protection in the status quo.

Nevertheless, one disappointing finding is that despite the satisfactory level of protection for the minority shareholders in joint-stock corporations (public and close), the Saudi legislators have yet to realize the close corporations as separate entities—with their issues and ways of governing—from public ones. The Ministry of the Commerce and Investment (by its regulatory role) issued some regulatory and procedural rules for the unlisted corporations, yet these rules hardly cover the issues of the minority shareholders. Instead, they provide instructive and implementing steps on how to apply the rules of the Law, which, similar to its predecessor, has ignored recognizing the close status for joint-stock corporations. The absence of the close corporations in the Law reflects the gap in the Saudi legal scholarships that fail to distinguish between the public and private corporations. During 2015 and 2016, four out of six GCC countries—namely Saudi Arabia, the United Arab Emirates, Qatar, and Kuwait—updated their corporate legislations by introducing new corporate laws. Three of which (the Emirati, Qatari and Kuwaiti corporate laws) have treated the close corporation as a different entity that requires special rules, making the Saudi Companies Law the only in the region that has no mention of the close corporation. Thus, a supplementary regulation or some reforms to the current laws are of the dire need to recognize the close corporations as entities that, despite their similarities with public corporations, have distinct features (e.g., lack of marketability, small number of shareholders, and stable shareholdings) requiring a regulatory framework different from the existing one.

That being said, the Law falls short of regulating some close corporations' affairs. Such affairs include the shareholder deadlock and squeeze-out regulations. The Law provides no mechanism to resolve the shareholder deadlocks, which commonly occurs in a two-shareholder corporation. If the shareholders fail to resolve the deadlock contractually, it is incumbent upon the law to propound some mechanisms that would protect profitable businesses from dilapidating.

Furthermore, unlike other corporate laws, the Saudi Companies Law of 2015 has no right or rule by which the 90% shareholder would exclude the minority shareholders from the corporation. That contributes to the problem of the minority shareholder control and opportunism, as discussed below.

Moreover, the research found that the Law promotes an effective reporting system coupled with statutory rights for shareholders to stay informed and make informed decisions. Through case laws, the right to access corporate information and inspect the corporation's books and records has always been honored and upheld. As a director of the corporation, the Law specifies directorial duties to report to shareholders as a separate organ about corporate activities and potential self-dealing, which makes directors an indispensable player in the statutory protection of minority shareholders' interests.

As a matter of conceptual view, the research found that the use of prescriptive and mandatory rules in regulating the internal affairs of the corporation may result in opportunistic and abusive behaviors by minority shareholders. There are scenarios where theoretically majority shareholders rely on the cooperation of minority shareholders. For share issuance, the Law requires, for instance, the approval of at least 75% of the shares in a special shareholder assembly attended by at least two-thirds of the outstanding shares. Unless the dominant shareholder possesses 75% of the outstanding shares, he has to seek assistance from minority shareholders to issue more shares. To address this issue, the research suggests that the Law impose a duty on shareholders to prevent them from abusing their voting rights in harming the general welfare of the corporation or to the detrimental of the corporation or its dominant shareholder. Another solution is to subject the unfounded refusal to issue some shareholder resolutions to the judicial scrutiny and statutory

sanctions. For example, the court may consider their votes as inconsistent with the overall interest of the corporation.

Moreover, with the legislative absence in reforming and addressing the needs of close corporations, the study calls for widening the role played by the judiciary in protecting minority shareholders in Saudi close corporation. Courts should advance to widen their repertoire of remedies when it comes to tensions and clashes among shareholders in close corporations. In reviewing the judicial role in the enforcement of the Companies Law, one may conclude that as the commercial judiciary has been developing, the legislative body seems to overlook the supplementary and ‘gap filling’ roles the judicial body could play. Ideally, with the establishment of commercial courts in late 2017 and the appointment of specialized judges, the Saudi legislature should broaden and entrust the judiciary with more powers to review and determine corporate disputes (e.g., opportunistic and abusive behaviors by minority shareholders) instead of being limited to the boundaries of the current CL. Also. It should have statutory leeway to assess whether a shareholder has committed oppressive conduct and thus determine what remedy is equitable.

Part Four: Concluding Remarks

As Saudi Arabia continues to advance its transformative 2030 Vision and enact laws and regulations deemed necessary to accomplish its economic and social goals, this study contributes to the improvement of the current laws and a prescription to fix the regulatory framework of one of the predominant business vehicles, close corporations. A robust legal system is a crucial element in any endeavor to boost economic prosperity and captivate foreign direct investments. Nevertheless, these changes have yet to be implemented in a way that ensures the stability of the market, gains reliability of its business owners, and reinforces the predictability of its judiciary. Hence, with more data in the near future, further studies ought to focus on the impacts and

ramifications of some mandatory rules of the Law (e.g., the regulatory cap on director compensations) on the corporation's performance and its management freedom.

This research contributes to the ongoing debates over contractual and legislative approaches as it provides a case study of a legislative approach to minority shareholder protection. Albeit some of its shortcomings, it proves that company laws may have a stronger protective role than what contractarians and advocates of the contractual approach claim. Countries with similar features (weak institutions and developing judiciary) may find the corporate governance in this research an effective approach to protecting minority shareholders in close corporations, while importing corporate governance of advanced economies (the U.S. and the U.K.) require more than laws.

In the end, by analyzing and criticizing the statutory protection for minority shareholders in Saudi Arabia, this research is a humble contribution to the international debates over minority shareholders' protection as well as to the national endeavors to modernize the country and update its legal system.

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-

CURRENT POSITION

King Saud University, College of Law and Political Science, Riyadh, Saudi Arabia

Lecturer

May 2015 – present

EDUCATION

Indiana University Bloomington Maurer School of Law, Indiana, United States

Juridical Degree of Law (S.J.D.)

May 2019

- Defended successfully my doctoral dissertation (titled: Protecting Minority Shareholders in Close Corporations: An Analysis and Critique of the Statutory Protection in the Saudi Companies Law) before the dissertation committee, comprised of Prof. Jayanth Krishnan (Director of Stewart Center on the Global Legal Profession), Prof. Donna M. Nagy (Executive Associate Dean for Academic Affairs), and Prof. Brian J. Broughman
- Received the Award of Excellence for Outstanding SJD Dissertation 2018-2019
- Co-founded and presided the International Students Association (ISA)
- Acted as a mentor and ambassador for incoming students

Cornell University SC Johnson College of Business, New York, United States

Executive Education in Leadership Essentials

March 2019

- Completed the following e-Cornell courses: Building High-performing Teams, Managing Team Performance, Interpersonal Communication Skills, Effective Hiring and Interviewing, and Managing Time and Priorities

Harvard Law School, Massachusetts, United States

Executive Education in Negotiation and Dispute Resolution

December 2018

- A highly interactive semester-length seminar that explores the ways that people negotiate to create value and resolve disputes
- Designed both to improve understanding of negotiation theory and to build negotiation skills, the curriculum integrates negotiation research from several academic fields with experiential learning exercises
- Engaged in a series of hands-on simulations set in domestic and international contexts, building from simple two-party encounters to complex multi-party scenarios
- Learned about psychological aspects of bargaining, value creation, and distribution, coalition dynamics, and intra-team negotiation, with a special focus on organized preparation and process analysis

University of Southern California Gould School of Law, California, United States

Master of Laws (L.L.M.)

May 2015

- GPA: 3.47/4.00
- High Honors: Reviewing and Negotiating Business Contracts (4.1), Mergers and Acquisitions (3.9), Directed Research (4.0)
- Honors: Securities Regulation (3.5), Partnership and Limited Liability Companies (3.6)



- Obtained a certificate business law after completion of 17 in-class units of selective business law subjects
- Co-organized the Annual Entertainment Law and Business Institute

University of California Los Angeles, California, United States

Academic English Certificate

June 2014

- Completed Academic Intensive English Language Program as a full-time student
- GPA: 3.80/4.00

King Saud University College of Law and Political Science, Riyadh, Saudi Arabia

Bachelor's Degree in Laws (L.L.B.)

June 2011

- GPA: 4.87/5.00
- Ranking: 3rd in Class of 2011
- Awarded the First Class of Honor
- Named to the Dean's List for Outstanding Students
- Participated in an abroad training program for two weeks, the United Kingdom, 2011
- Served in the Dean's Advisory Council
- Represented undergraduate students in the Faculty Academic Guidance Committee
- Member of the Saudi Society of Political Science
- Co-organized a workshop entitled "Contemporary Tendencies of Judicial Compensation in The Saudi Board of Grievances," 2010
- Active member in the Law Club for three consecutive years

Al-Imam Muhammad Ibn Saud Islamic University, Al-Ahsa, Saudi Arabia

H.S. Diploma in Sharia and Arabic Language Science

June 2007

- Attended Al-Ahsa Sharia Institute, one of the first-ever five Sharia Institutes established in Saudi Arabia in 1374 Hijri (corresponding to 1954) by the then-grand Mufti, and with the primary focus on the teachings of Sharia subjects alongside the science of Arabic language.
- GPA: 98.80%
- Ranking: 3rd in Class of 2007

PROFESSIONAL EXPERIENCE

Harvard University, Law School, Massachusetts, United States

Visiting Researcher

May 2017–December 2018

- Supervised by Professors Holger Spamann and Guhan Subramanian while in residence at Harvard Law School
- Designed and coordinating a writing workshop (3 units) for visiting researchers and scholars.
- Co-established the first-ever Saudi community at Harvard, consisting of over 40 Saudis from different Harvard schools.
- Volunteered in the administration and organization of Arab Conference titled "Arab Visionaries: Claiming Tomorrow" at Harvard Law and Business Schools from November 9 until 12, 2017
- Communicated my research and collaborating with other researchers and scholars where appropriate to transfer and exploit knowledge for the benefit of my project, the legal literature and society as a whole
- Wrote my research project in partial fulfillment of the requirements for the degree of Doctor of Juridical Science (S.J.D.) at Indiana University Bloomington Maurer School of Law



- Managed and sustaining progress in accordance with the agreed research plan, including the submission to the supervisory committee of my dissertation as required
- Presented to other visiting researchers, scholars, and interested students in the Colloquium Series about contemporary issues in the field of corporate governance, including minority shareholder protection and other related shortcomings
- Audited several HLS unique courses, including Current Issues in Corporate Governance, Economic Analysis of Law, Current Issues in Securities Regulation, Corporate and Capital Market Law and Policy, and Seminar in Law, Economics and Organization.

King Saud University, College of Law and Political Science, Riyadh, Saudi Arabia

Lecturer

May 2015–present

- Taught Corporate Law (3 units) and Maritime Law (2 units) courses to undergraduate students
- Collaborated in several internal committees: The Academic Quality and Accreditation Committee, The Science Communication and Seminars Committee, and the Social Affairs Committee,
- Reviewed and arbitrated student complaints
- Granted a full scholarship to pursue a Doctor of Philosophy degree in law, with sabbatical leave starting August 2016

King Saud University College of Law and Political Science, Riyadh, Saudi Arabia

Graduate Teaching Assistant

February 2012- May 215

- Provided lectures in professors' absence by teaching some law courses, Commercial Law, Civil Law and Principles of Law, for undergraduate students
- Graded students' assignments and quizzes
- Advised and mentored new students through presentations
- Granted a full scholarship to pursue an LL.M. degree
- Enrolled in a one-semester preparatory program designed for university teaching assistants and lecturers to prime them for postgraduate studies through various courses and workshops

Alsaleh Office for Lawyering and Legal Consulting, Dammam, Saudi Arabia

Paralegal

June 2011–February 2012

- Drafted a number of legal documents and correspondence
- Performed delegated legal work and law office administration
- Conducted legal research and presentations
- Assisted with Filing exhibits, briefs, appeals and other legal documents with courts or opposing counsels

Saudi Arabian Oil Company Saudi Aramco, Dhahran, Saudi Arabia

Intern in Labor Relations Division

July–September 2010

- Observed trials with the company's representatives who represent Aramco in its disputes before the Settlement of Labor Disputes Authority (the Labor Court)
- Drafted grant proposals and reviewed the company's bylaws and the employee's guidelines
- Attended several training courses on safety and other human resources development



CONFERENCE PRESENTATIONS

The 2018 National SJD Roundtable

Georgetown University Law Center, Washington, D.C.

November 16th, 2018

- Presented and shared orally an overview of my doctoral dissertation titled “Saudi Close Corporation: An Analytical and Critical Study of the Statutory Protection of Minority Shareholders”

The 9th National Business Law Scholars Conference

University of Georgia School of Law, Athens, Georgia

June 21st – 22nd, 2018

- Presented orally chapter fourth of my in-progress dissertation , *the Statutory Protection for Minority Shareholders in Close Corporation*.

The 7th International Conference on Interdisciplinary Legal Studies

Harvard University, Boston, Massachusetts

November 20th – 22nd, 2017

- Presented orally my paper, *Saudi Family Businesses upon their founders’ death*, after it was peer-reviewed and accepted for oral presentation.

ACADEMIC RESEARCH AND PROJECTS

❖ English

The Statutory Protection for Minority Shareholders in Close Corporation

August 2017–May 2019

- A doctoral dissertation that casts light on lately-enacted regulations in Saudi Arabia, including the Companies Act and other ministerial ordinances, ensuring a high level of corporate governance practices for Saudi close corporations
- Underlining the widespread oppressive actions and practices that are confronted by minority shareholders in across the global in general, and in Saudi Arabia in particular
- Collecting and analyzing data regarding the contractual approach in protection of the minority shareholders on one side, and comparing to the statutory protection on other side
- Providing a nutshell about the history and the evolution of the corporation and its regulations in the region, and how the ownership structure plays an essential role in shaping the legal framework
- Analyzing and critiquing the recently-adopted corporate governance principles and finding out how they respond to the most common corporate governance practices in the world
- Work in Progress

Saudi Family Businesses upon their founders’ death

January- May 2015

- Analyzed a brief introduction to the Sharia inheritance law as applied in Saudi Arabia and its impacts on the business field, particularly family-owned businesses
- the outcomes of such an application of the inheritance law on these businesses on different levels, the Saudi market and national economy as whole, international investors and companies and the business itself
- Articulated some of the ongoing governmental and business owners’ efforts to the adoption of corporate governance of family businesses
- Grade Received: A (4.0 High Honor)



❖ Arabic

B.O.T (Build-Operate-Transfer) implementations in Saudi Arabia

February- May 2011

- A graduation research project that identified the theoretical scope of B.O.T. contracts and regulations through a comparative study of laws in Saudi Arabia, Jordan and Egypt
- Analyzed and elucidated the practical and judicial scope of B.O.T contracts in Saudi Arabia and presented on the huge governmental projects for the two Holy Mosques
- Visited the Saudi Board of Grievances to obtain some cases related to these contracts
- Grade Received: A+
- Unpublished

The Contractual Liability of Airlines for Delay and Cancellation, Comparative study between Sharia and the Positive Law.

August- December 2010

- A term paper for Aviation Law course (3 Units) undertook a detailed, comparative study of both the Sharia and positive laws concerning the airline's liability when a flight is delayed or cancelled due to either the airline's negligence and malfeasance, or force majeure
- Debated the validity of the limited liability or no liability clause according to the viewpoint of Sharia and aviation treaties
- Grade Received: A+

A Critique of Mixed Marriage in the Saudi Arabian Citizenship Act

January- May 2010

- A 20-page article assessed the longstanding law of citizenship and its treatment of mixed marriage. The law poses as an obstacle as it imposes a number of restrictions on Saudis as they choose their future wives. These restrictions increase when a Saudi female decides to marry non-Saudi male
- Made some suggestion for reforms in the act, taking into consideration the special nature of the Saudi society and reviewing other counterpart laws of neighboring countries sharing with Saudi Arabia cultural and religious backgrounds.
- Grade Received: A+

LEGAL AND PROFESSIONAL DEVELOPMENT

- *Edad* Program (18 hours), McKinsey & Company, Boston, Massachusetts, April 2019
- Basic Mediation and Restorative Justice Training (36 hours), Community Justice and Mediation Center, Bloomington, Indiana, September 2016
- Spotlight on Saudi Arbitration Law, Riyadh Chamber of Commerce and Industry, 2011
- The Technique of Criminal Arguments, Law Club, King Saud University, 2010
- Qualifying as an Arbitrator (12 hours), Adel Center, Riyadh, 2010
- Legal Protection for Commercial Activities, Law Club, King Saud University, 2009
- Laws of Jurisdiction in Saudi Arabia, Law Club, King Saud University, 2009
- Skills of Argumentation, Law Club, King Saud University, 2009

RESEARCH AND TEACHING INTERESTS

- Corporate Law: Corporate Governance, Corporate Finance, and Startup and family Businesses
- Mergers and Acquisition
- Securities Regulation
- Law and Economics
- Legal Profession



SOCIAL SERVICES AND VOLUNTEERING

- Language Exchange Partner, Indiana University Bloomington, August 2016–July 2019
- Volunteer in the Islamic Center in Bloomington, August 2016–July 2019
- Volunteered in the administration and organization of Arab Conference titled “Arab Visionaries: Claiming Tomorrow” at Harvard Law and Business Schools, November 2017
- Volunteered in a number of Student-led associations sponsored by the Saudi Arabian Cultural Mission in several U.S. institutions, including the University of California Los Angeles, University of Southern California, and Indiana University Bloomington, October 2012 – April 2019
- Mediator, Community Justice and Mediation Center, Bloomington, Indiana, September 2016-May 2017
- Registered Volunteer in Gouth Team in association with the General Directorate of Civil Defense, Saudi Arabia, 2009- Present
- Language Exchange Partner, University of California Los Angeles, 2012 – 2014

LANGUAGE SKILLS

- Arabic (Native)
- English (Professional Fluency)

